**Consumer Challenge Panel (Panel 5)**

# Transmission for the Generations

Response to:

## Proposal by AusNet Services Transmission Group Pty Ltd

## and AER Issues Paper

For:

# AusNet Services Transmission Revenue Review 2017-22

**February 2016**

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## Summary

We make the following brief responses to the questions posed in the AER issues paper, by way of summary of the conclusions re have reached in considering the AusNet Service TRR 2017-22 and associated AER Issues Paper.

We have responded in summary form to each of the 15 questions posed in the Issues Paper. More detailed responses follow in subsequent sections

Questions

*1. Do you consider that AusNet Services has sufficiently justified its proposal for accelerating depreciation of assets removed from service?*

No. does not consider the accelerated depreciation proposal to be justified. Refer section 6. No nexus has been established between the depreciation cost that is proposed and the impact on AusNet Services' transmission business of new technology and changing consumer habits.

We contend that the link between disruptive technologies and risk to AusNet Services' transmission business has not been adequately demonstrated by AusNet Services. The impact on the business' line usage is unclear. AusNet Services' proposal is incomplete and not fully specified, and therefore the AER should not accept it. Given the lack of evidence, our view is that an adjustment to AusNet Services' revenues is inappropriate at this stage.

*2. Do you consider that there is some prospect that utilisation rates on AusNet Services Services' network may fall in the future (over the next five years and beyond)?*

Yes, it is intuitive that there will be some prospect, for falling utilisation, evidence for the likelihood of it is the declining Multifactor Productivity (discussed in section 4, Benchmarking)

A prospect of falling utilisation is inadequate justification for what could be a significant impost on consumers in years to come. AusNet Services (and other network businesses) must provide hard evidence of falling utilisation, and nexus between falling utilisation and their proposals for future sculpting of 'return of assets' under the building block approach, and better justify claims to apply accelerated depreciation.

*3. Do you consider that increasing depreciation is an appropriate response to expectations of falling utilisation?*

It is one way of dealing with the changing environment. Equally, if not more importantly, network businesses must adjust their capital expenditure plans to reflect the changing environment.

There is also an important question about applying the NEO, on an intergenerational basis. The NEO applies equally, we believe, to present and future customers. Increasing depreciation charges, increasing current consumer burden, may be doing so to give unfair advantage to future consumers, or to future network profits – outcomes contrary to the NEO for current consumers.

*4. Are there other approaches that could be employed to respond to the risk of falling utilisation?*

Under the propose respond model, it is up to the network businesses to work this out.

*5. Do you agree with AusNet Services' response to its stakeholder consultation on depreciation?*

AusNet Services states in their proposal "participants were strongly against the application of any type of accelerated depreciation. Specific feedback included questioning why they should bear any risk of asset stranding when in a competitive environment, this risk is borne by the firms making an investment decision." Despite this very clear feedback from consumers, AusNet Services has decided to push ahead anyway with their proposal for an accelerated depreciation approach, because it suits them rather than listening to their customers.
The CCP rejects the AusNet Services` approach to accelerated depreciation and the disappointed at their rejection of clear consumer feedback also opposing the accelerated depreciation approach

*6. Do you consider that AusNet Services has sufficiently justified its chosen multiple used for the DV method?*

Definitely not. Refer section 6. There is no nexus between a tax depreciation acceleration rate used by Government to encourage investment, and a rate that reflects asset utilisation and remaining life.

*7. What are the future implications if the DV depreciation method is applied as proposed by AusNet Services?*

The AER would be accepting a flawed and poorly thought out 'knee-jerk response' to changes in AusNet Services' operating environment, and embedding this in the prices faced by consumers for many years to come if the diminishing value method for depreciation is applied.

*8. Are there other issues we should consider in assessing the merits of the DV depreciation method as proposed by AusNet Services?*

We refer you to section. Our view is that there is some merit in an approach to return of capital that matches the way assets are utilised, however there are also drawbacks.

*9. Do you consider that AusNet Services has sufficiently justified its capex proposal?*

No. The proposal is too high, when compared to past expenditures.

*10. Do you consider that AusNet Services has adequately considered customer views in developing its capex proposal?*

Customer views as expressed through VCRs do appear to have been incorporated into the planning processes of AusNet Services, which is to be commended. We are aware of some large user disquiet as to expenditures. The AER must assess the proposal in the context of NER requirements regardless of whether it has already assessed these same projects in the past (given some of these projects have been in the pipeline and under construction for many years.)

*11. Do you consider that AusNet Services has sufficiently justified its opex proposal?*

Of most significance is the projected 13% increase in controllable opex for the TRR period. Further, the proposed opex starting in 2017-18 is appreciably higher than the trend regulatory allowance would indicate.

Of particular concern is the significant increase in the first year of the TRR period. We understand that there is a small reduction in the following couple of years and then returning to near 2017-18 levels for the last two years of the control period.

Opex levels more akin to those prevailing before the most recent regulatory period should be carefully considered

*12. Do you consider that AusNet Services has adequately considered customer views in developing its opex proposal?*

In some aspects, AusNet Services has reasonably considered consumer views in developing their opex proposal and has shown goodwill in their approaches. However, the rejection of clear consumer advice regarding accelerated depreciation in a failure to adequately consider consumer views, Though we are not aware of consumers being given information about opex increases of the order of 13% being proposed, consumers were not in a position to provide advice on this.

*13. Do you have any comments on AusNet Services proposed approach to calculating the rate of return, which departs from our guideline?*

We refer you to section 8.

The rates set by the AER in its October 2015 fact sheet on rate of return (6.1%) and November 2015 Draft Decision for Australian Gas Networks (6.01%), are lower than that proposed by AusNet Services (7.22%), but we suggest the rate could be lower.

Within the Guidelines, the AER could still set a lower return on equity by specifying a market risk premium of 6.0 or below and an equity beta closer to 0.4 than 0.7. Point estimates for these parameters that are within the AER's range but lower than those set by the AER to date would be more in the long term interests of consumers while still meeting investors' rights to an adequate return on capital invested. Using the AER's most recently applied risk free rate of 3.02% in conjunction with a market risk premium of 6.0 and 0.4 would result in a cost of equity of 5.4%.

The approach taken by the AER to measuring the cost of debt is acceptable to us at this time. Using the AER's most recently applied cost of debt of 5.37% in conjunction with a cost of equity, it is our view that the rate of return that is in the best interests of consumers would be 5.4%.

Proposed parameters, summary:

| | |
|---|---|
| Gearing: | 60% |
| Credit rating | BBB+ |
| Market Risk Premium: | 0.6 |
| Beta | 0.4 |
| Cost of Equity | 5.4 |
| Cost of Debt | 5.37 |
| Rate of Return | 5.4% |

*14. Do you agree with AusNet Services proposal to use a gamma value of 0.25 in valuing imputation credits?*

No. AusNet Services proposes a gamma of 0.25. The Guideline estimates a gamma of 0.5, however in recent decisions the AER has departed from the Guideline and used 0.4. We can see no clear reason for a further downward departure from this Guideline and encourage the AER to apply the guideline gamma of 0.5.

*15. Please provide your comments on the quality of the consumer engagement conducted by AusNet Services in preparing its revenue proposal*

Our criteria for assessing consumer engagement are:

- previous consumer engagement,
- the process for consumer engagement in developing this regulatory proposal
- the extent to which consumer input has been heard and applied in developing this regulatory proposal.

Considering previous consumer engagement, we conclude that AusNet Services has made significant progress in seeking to apply consumer engagement principles and support them in continuing to apply the IAP2 spectrum as a best practice framework. Compared to previous consumer engagement, considerable progress is evident.

For this TRR, AusNet Services has made solid efforts to engage with end consumers, within a broader 'stakeholder' engagement rubric. Their progress in applying the first two levels of the IAP2 spectrum, 'inform' and 'consult' has been considerable and their goodwill in seeking engagement, undeniable. In general, the two-way nature of consumer engagement is still developing, particularly for the 'collaborate' and 'empower' elements of the IAP2 spectrum

In applying consumer engagement to this TRR, there has been reasonable responsiveness to some capex and opex views of consumers, including the confidential pass through event. The major disappointment has been in rejecting strong consumer advice regarding accelerated depreciation.

We suggest that the understanding of the IAP2 process is still developing, as it is a 'two – dimensional framework, not 'one dimensional.' The missing aspects of application of IAP2 is the "Promise to the Public" dimension.

# 1 Introduction

## 1.1 The role of the Consumer Challenge Panel

The Consumer Challenge Panel (CCP) was established on 1 July 2013 to be a 'critical friend' for the Australian Energy Regulator (AER), by considering regulatory issues from an end consumer perspective. The AER implemented this process as a part response to the information asymmetry that exists in regulatory processes, to the detriment of consumers.

The primary duty of the CCP is to provide advice to the AER on whether proposals by network operators meet the National Electricity Objective (NEO), in particular whether proposals are in the long-term interests of consumers. This means taking into account costs to consumers and other interests of consumers such as safety and reliability. To meet this duty the CCP is required to challenge the AER on decisions that go into its determinations by providing input on issues of importance to consumers.

The CCP's role is therefore to:

- advise the AER on whether a network business's proposal is justified in terms of the services to be delivered to customers; whether those services are acceptable to, and valued by, customers; and whether the proposal is in the long term interests of consumers; and
- advise the AER on the effectiveness of network businesses' engagement with their customers and how this engagement has informed, and been reflected in, the development of their proposals.

The CCP provides consumer perspectives to the AER to better balance the range of views considered as part of its decisions. However, its role is limited. There remains significant asymmetry between powers of demand and supply players in this market and the AER must still provide a surrogate for competition. The CCP is not designed to be **the** representative of the 'demand' side of the electricity market.

The CCP is resource-constrained and cannot be expected to provide expert advice to counter experts retained by network operators; these experts must be retained by the AER. The CCP can, however, provide advice to the AER on key areas where it is of the view that the long term interests of consumers are unlikely to be met under proposed arrangements, and where there is scope for the AER to exercise its judgment to better do so or to obtain expert advice that might assist it in reaching an independent view.

## 1.1 Subpanel for AusNet Services transmission

The CCP is organised into subpanels in order to deal with the large number of regulatory determinations made by the AER. The sub panel considering the AusNet Services Transmission Revenue Review (TRR) 2017-22 comprises Mark Henley and Ruth Lavery.

## 1.2 Our views and evidence

In our deliberations and in preparing this submission we have identified a number of issues, both 'higher order' and 'detail' that warrant close consideration. We have actively sought data / evidence to be able to support our arguments; however this has not been possible in considering some issues. So we have produced this submission with three different levels of detail, these being:

1. This issue is important and we encourage the AER to investigate further, utilising their expertise,

2. Here is our opinion, as experienced participants in energy regulatory processes,

3. This is an issue for which we present data that supports the perspective that we are putting.

We also recognise that under the National Electricity Rules, the AER has the discretion to exercise its judgment in coming to a determination. We present data, opinion and experience to assist the AER in exercising its discretion and reiterate the importance of the AER taking evidence and advice from many sources, using the 2013 developed guidelines to assist in deliberation and bringing this substantive body of perspective and information together, with the discretion that the AER has to make determinations – to promote the long term interest of consumers.

## 1.3 Transmission for the Generations

We have titled this submission "Transmission for the Generations" because application of the National Energy Objective to intergenerational equity is a key theme for this transmission revenue review, arguably more starkly so than with other network regulatory proposals.

The question of intergeneration fairness is most clearly asked by a strongly presented proposal to move to an accelerated depreciation methodology. Meaning higher charges in the shorter term, but maybe lower prices in the longer term due to a lower Regulated Asset Base than would otherwise have been the case.

A broader question of new technologies, particularly energy storage and the changing nature of generation, specifically from renewable sources also pervades network planning and thinking.

Of course, transmission for generation is what TNSP's do.

# 2 Consumer engagement

A key role of the CCP is to provide advice to the AER about the effectiveness of consumer consultation undertaken by network providers. A consumer Engagement guideline was developed during 2013, with extensive industry and consumer input. This guideline serves as a reference point for consumer engagement analysis.

## 2.1 What would be good practice

A part of the role of the consumer challenge panel is to consider the consumer engagement processes undertaken by network business and to provide advice to the AER with regard to the appropriateness of the consumer engagement and the extent to which the input from consumer engagement has been picked up in a regulatory proposal.

We note that much of the recent consumer engagement experience in application of the guideline has related to distribution businesses and that historically transmission businesses have generally regarded themselves as being detached from 'end consumers', other than very large 'direct connect' customers. However, the NEO focus on the long term interests of consumers applies to transmission network service providers (TNSP's) just as much as to distribution businesses (db's) and retailers. It is in this context that we have considered the AusNet Services TRR, 2017-22

AusNet Services has used the term 'stakeholder engagement in their proposal, which is reasonable given that as a transmission business generators feeding into a transmission network are stakeholders as our distribution network businesses and in the case of AusNet Services transmission business in Victoria, AEMO which has a specific planning role with regard to transmission services in Victoria. We regard end consumers as a specific subset of stakeholders and it is this group of stakeholders to which the CCP is required to give focus. We concentrate on end users as consumers for a transmission business meaning both direct connect customers e.g. large energy users as well as household and small business and also medium-sized enterprises who receive their electricity via a retailer or in some instances their distribution business.

In considering our assessment of AusNet Service's consumer engagement approach we are giving main consideration to 3 elements:

- previous consumer engagement,
- the process for consumer engagement in developing this regulatory proposal
- the extent to which consumer input has been heard and applied in developing this regulatory proposal.

Previous consumer engagement

We recognise that the AER conducted wide consultation with a variety of stakeholders during 2013 to develop a range of guidelines including a consumer engagement guideline. Processes to strengthen consumer input into network regulation processes were also strengthened from about this time including with the establishment of the consumer challenge panel (as well is the steps taken to establish what is now Energy Consumers Australia).

Consumer engagement has been a relatively small component of stakeholder engagement for transmission businesses in previous regulatory proposals and transmission businesses have generally

seen themselves as a step further removed from end consumers, compared with distribution businesses and therefore historically have not made major efforts to engage with consumers.

We accept that direct consumer engagement is a relatively new process for transmission businesses, including AusNet Services. Engagement with Transmission businesses has also been a relatively new process for some consumer groups as well.

<u>The process for consumer engagement in developing this regulatory proposal</u>

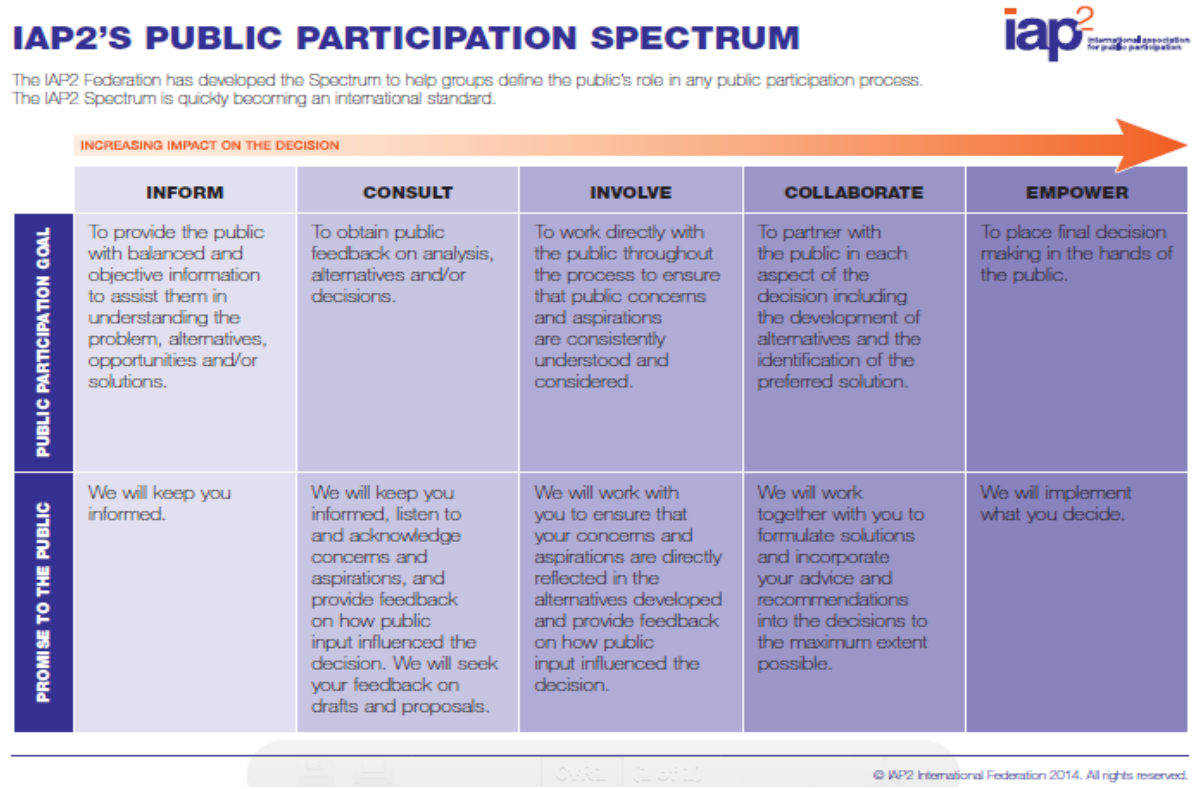
AusNet Service state that the "use of the IAP2 guideline emphasised to stakeholders that AusNet Services engagement program was consistent with AER expectations"

We agree that this International Association the Public Participation (IAP2) guideline is a widely used and appropriate approach upon which to build consumer engagement processes. The IAP2 spectrum is given in figure 1 and shows the spectrum for public participation, with five core progressive elements in the public participation goal: inform, consult, involve, collaborate and empower.

The spectrum also identifies "promise to the public" for the five public participation goal categories, which in the context of energy regulation we understand to be "promise to the consumer."

We highlight that the IAP2 spectrum is 'two- dimensional', not a 'one-dimensional' straight line spectrum as often interpreted by network service providers.

**Figure 1, IAP2 public participation spectrum:**[1]



**IAP2'S PUBLIC PARTICIPATION SPECTRUM**

The IAP2 Federation has developed the Spectrum to help groups define the public's role in any public participation process. The IAP2 Spectrum is quickly becoming an international standard.

INCREASING IMPACT ON THE DECISION

| | INFORM | CONSULT | INVOLVE | COLLABORATE | EMPOWER |
|---|---|---|---|---|---|
| PUBLIC PARTICIPATION GOAL | To provide the public with balanced and objective information to assist them in understanding the problem, alternatives, opportunities and/or solutions. | To obtain public feedback on analysis, alternatives and/or decisions. | To work directly with the public throughout the process to ensure that public concerns and aspirations are consistently understood and considered. | To partner with the public in each aspect of the decision including the development of alternatives and the identification of the preferred solution. | To place final decision making in the hands of the public. |
| PROMISE TO THE PUBLIC | We will keep you informed. | We will keep you informed, listen to and acknowledge concerns and aspirations, and provide feedback on how public input influenced the decision. We will seek your feedback on drafts and proposals. | We will work with you to ensure that your concerns and aspirations are directly reflected in the alternatives developed and provide feedback on how public input influenced the decision. | We will work together with you to formulate solutions and incorporate your advice and recommendations into the decisions to the maximum extent possible. | We will implement what you decide. |



Source, International Association for Public Participation

[1] https://www.iap2.org.au/resources/public-participation-spectrum

We regard the application of the IAP2 spectrum by AusNet Services is a useful way for measuring consumer engagement; considering both the extent of progression along the public participation goal spectrum, and the extent to which the "promise to the consumer" is clear and is delivered upon

The extent to which consumer input has been heard and applied

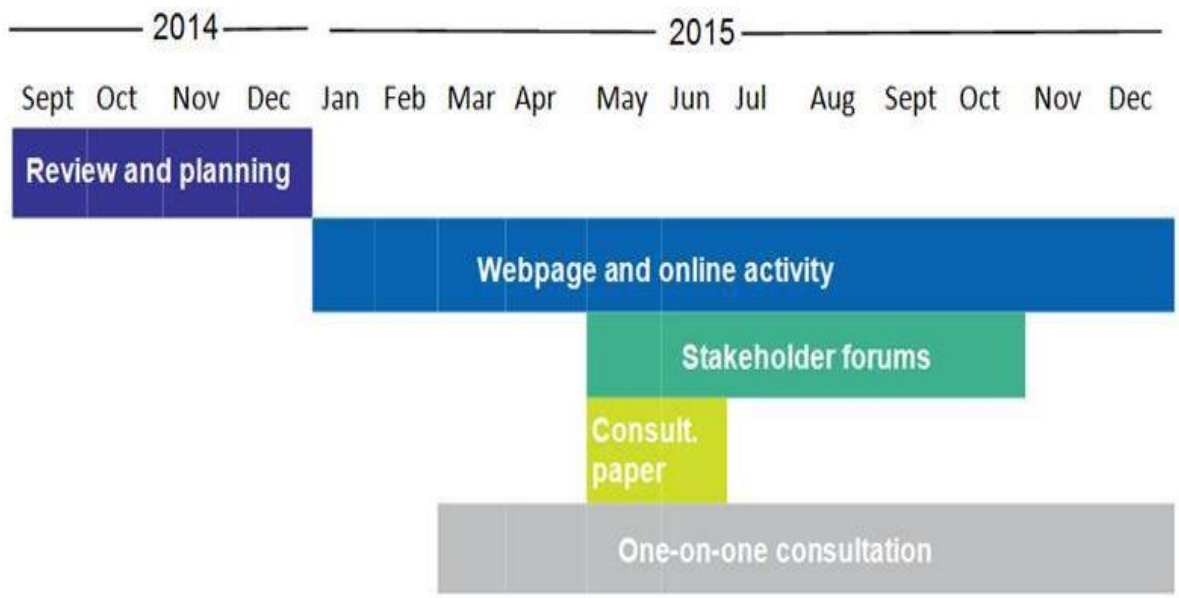
The third means for assessing the effectiveness of consumer engagement is the very pragmatic question of the extent to which advice provided by consumers has been sought, heard and most importantly applied.

## 2.2 Engagement undertaken by AusNet Services has done, and how it is incorporated into the proposal

A key question is whether AusNet Services has met the consumer engagement guideline criteria and therefore how much attention they have given to consultation/stakeholder views.

Figure 2 shows the outline of timing and strategy for stakeholder engagement in the lead up to the lodging of this regulatory proposal in late 2015. Once the planning and review processes were undertaken, AusNet Services has applied four main strategies for engagement: webpage and online activity, stakeholder forums, the production of a consultation paper with requests the written responses dealing specifically with accelerated depreciation and finally one-on-one consultation.

Figure 2, AusNet Services Consumer Engagement Plan




Source: AusNet Services Regulatory Proposal 2017-22

Website

AusNet Services developed a dedicated webpage while developing their revenue proposal, with its main objective being to inform stakeholders and provided a dedicated email address for queries or feedback. The revenue proposal states that there were 906 unique visits to the website.

Stakeholder forums

Three forums were conducted, in Melbourne, in the lead up to the TRR being submitted to the AER, these forums are summarised below.

Forum 1: 26th March 2015.

- An introduction to AusNet Services;
- Approach to stakeholder engagement;
- Benchmarking performance;
- Responding to changes in the Value of Customer Reliability and forecast demand;
- Initial operating expenditure step changes; and
- An introduction to accelerated depreciation.

Forum 2: 28th May 2015

- Stakeholder engagement update;
- Value of Customer Reliability (presented by AEMO);
- West Melbourne Terminal Station – project update;
- The latest forecasts of revenue, price and expenditure; and
- Consultation on key issues: price vs reliability and accelerated depreciation.

Forum 3: 12th October 2015

- Emerging Energy Market Trends; and
- Overview of the Revenue Proposal – outlining the building blocks, the impact of stakeholder feedback and documentation which will be claimed as confidential.

We note that a fourth forum is planned to discuss "key elements of the revised proposal with stakeholders. Feedback from the third and fourth forums will be incorporated into the revised revenue proposal."

Consultation paper

A consultation paper dealing with accelerated depreciation was produced and invited stakeholders to make written submissions

One to One Consultations

AusNet Services state that they offered the opportunity for one-to-one consultations with stakeholders with this opportunity being taken up by the Energy Users Association of Australia.

## 2.3 Our views on the consultation that has been undertaken

In Figure 3 below, AusNet Services rate their engagement activities against the AER consumer engagement guideline, which also recognised the IAP2 spectrum as a best practice guide to consumer engagement.

Figure 3. Assessment of Stakeholder Engagement by AusNet Services

**Table 3.1: Assessment of engagement activities against Guideline principles**

| Activity | Purpose | Consumer Engagement Guideline: Best Practice Principle |
|---|---|---|
| **Review and Planning** | Identify relevant existing information to gain insights into consumer views.<br>Gather stakeholder preferences related to design of TRR stakeholder engagement program. | Transparent<br>Clear, accurate and timely communication |
| **Webpage Engagement** | Enables all stakeholders to access information relevant to the TRR engagement program, including event details and key publications.<br>Provide a channel for feedback. | Clear, accurate and timely communication<br>Accessible and inclusive<br>Transparent |
| **Stakeholder Forums** | Provide a progressive series of updates and feedback opportunities on the development of the regulatory proposal.<br>Obtain consumer views and preferences on specific aspects of the proposal.<br>Address the AER / CCP focus on service providers presenting genuine 'costed options.'<br>Conduct feedback surveys.<br>Publish presentations and discussion summaries shortly after the event. | Clear, accurate and timely communication<br>Accessible and inclusive<br>Transparent<br>Measurable |
| **Consultation Paper: Accelerated Depreciation** | Establish a dedicated channel for the subject of accelerated depreciation.<br>Gather submissions to inform the proposed approach to accelerated depreciation. | Clear, accurate and timely communication<br>Accessible and inclusive<br>Transparent |
| **One-on-one consultations** | Provide stakeholders with an opportunity for engagement that is tailored to their specific information and time requirements. | Clear, accurate and timely communication<br>Accessible and inclusive<br>Transparent |

Source: AusNet Services Transmission Revenue Review 2017-22

AusNet Services also summarise their engagement against the five public participation goal spectrum elements, as follows:

- *Inform.* Most stakeholder engagement activities, including stakeholder forums, the TRR webpage, one-on-one interactions and publications such as fact sheets and a consultation paper, served to educate and inform stakeholders about the TRR proposal.
- *Consult.* In addition, the forums, one-on-one interactions and a consultation paper gave AusNet Services the opportunity to receive stakeholder feedback, acknowledge concerns and provide specific information on how stakeholder input influenced the revenue proposal.
- *Involve.* AusNet Services was mindful of the need to provide opportunities for stakeholders to have their views directly reflected in the TRR proposal. The second 'deliberative' stakeholder forum gave participants this opportunity, with

the presentation of costed options on accelerated depreciation and capex-opex trade-offs.

- However, the planning of network connections and shared network augmentations in Victoria is the responsibility of, respectively, the connecting parties and AEMO. In these instances, AusNet Services directly implements what stakeholders decide, consistent with the higher levels of the spectrum – *Collaborate* and *Empower.* The direct application of the VCR in AusNet Services' replacement plans is another example of reaching these levels."
- AusNet Services envisages that, in future, more stakeholder engagement work could be conducted at these levels.

Development of this TRR has also involved consideration of a sensitive, and therefore confidential 'pass through' event. We observe that AusNet Services has managed this process well and has been as open with stakeholders as they could be, given the confidential nature of the matter.

### 2.3.1 The process for consumer engagement

We agree with AusNet Services to the extent that they have made significant efforts to inform and sound efforts to involve consumers, as per the IAP2 spectrum. This is evident through the website that was established for the period leading up to lodging the transmission of revenue review 2017-22 (TRR), the three stakeholder forums, the production of a discussion paper and the offer of one-to-one discussion/consultation. As individual members of the CCP we experienced AusNet Services staff to be extremely helpful and keen to respond to requests for information and to discuss aspects of consumer engagement.

We do not believe that consumer engagement processes were as effective for the "involve", "collaborate" and "empower" components of the IAP2 spectrum, as for "inform" and "consult".

It was our observation that the three forums were effective in involving consumers who participated but we are less convinced that the website was effective in involving because the TRR does not provide information about the number of people who contacted AusNet Services through the website. There were very small levels of involvement with both the discussion paper and one-on-one consultation processes.

Areas for improvement by AusNet Services regarding their application of "best practice approaches are in four main areas:

- application of consult and empower
- extent of proactivity in seeking consumer input
- rejecting consumer advice regarding "accelerated depreciation."
- Promise to the public

### 2.3.2 Application of consult and empower (as per IAP2 Spectrum)

AusNet Services states "However, the planning of network connections and shared network augmentations in Victoria is the responsibility of, respectively, the connecting parties and AEMO. In these instances, AusNet Services directly implements what stakeholders decide, consistent with the higher levels of the spectrum – *Collaborate* and *Empower.* The direct application of the VCR in AusNet Services' replacement plans is another example of reaching these levels."

This approach fails to recognise the meaning of the terms "collaborate" and "empower" in particular with regard to end consumers. The notion that because they do what AEMO as the planning body, or the generators ask, fails to recognise that collaboration is a two-way process with all stakeholders including consumers. We do not consider that there is a clear understanding of empowerment, in particular, as applied to consumer engagement. Empowerment means supporting consumers individually or as groups to come directly to AusNet Services able to articulate clearly what their needs are and to have AusNet Services take seriously consumer advice and demands and to actively negotiate directly about the implementation of these.

Similarly accepting the value of consumer reliability (VCR) as determined by AEMO is not an example of AusNet Services collaborating or empowering consumers. This is not to say that accepting the VCR calculated by AEMO is the wrong thing to do. Indeed, the most recent work to calculate VCR by AEMO is excellent and actively sought extensive consumer input, it is right that AusNet Services utilised this VCR calculation and apply it. It is just not a process that AusNet Services undertook in undertaking their own consumer engagement.

### 2.3.3 Extent of proactivity in seeking consumer input

Regarding their consultation paper process, AusNet Services says that they "received a single written submission on the consultation from another TNSP. Feedback was received that resource constraints impacted the ability of some stakeholders to provide written feedback on this document. We regard this as clear feedback from consumer groups that the process established by AusNet Services was difficult for consumer groups to comply with, suggesting that AusNet Services needed to find alternative approaches to engaging with consumer interests on this subject, rather than simply expecting resource constrained consumer groups to fit in with a process that was neat and comfortable for AusNet Services. We believe that AusNet Services should have applied other approaches to seek greater consumer engagement particularly on an issue about which AusNet Services clearly has strong views.

Regarding one-on-one consultation AusNet Services says "however, very few stakeholders expressed an interest in holding more detailed discussions on the TRR beyond the level of the forums. This suggests their preferred involvement was consistent with level one or two of the IAP2 engagement spectrum (inform and consult.)" We disagree with this conclusion, as with the consultation paper we suggest that this lack of response is more consistent with

resource constrained consumer groups and therefore means that AusNet Services need to make more effort to engage with consumers in a manner that is more time and energy efficient for all parties.

In short, we suggest that AusNet Services could have been much more proactive in seeking engagement from consumers, rather than simply expecting consumer interests to be able to comply with the processes and timelines that were most convenient for AusNet Services.

### 2.3.4 Rejecting consumer advice re: "accelerated depreciation."

Regarding accelerated depreciation, AusNet Services states, "participants were strongly against the application of any type of accelerated depreciation." Specific feedback included questioning why they should bear any risk of asset stranding when in a competitive environment, this risk is borne by the firms making an investment decision." Despite this very clear feedback from consumers, AusNet Services has decided to push ahead anyway with their proposal for an accelerated depreciation approach, because it suits them rather than listening to their customers.

### 2.3.5 Promise to the public

Central to the application of the IAP2 spectrum is the notion of "promise to the public" with the spectrum providing for different levels of promise for each of the five spectrum elements. We do not consider that AusNet Services have clearly stated the 'promise to the public' in applying their consumer engagement approach. We also accept that network businesses in Australia, in general are in the very early days of development this aspect of engagement from the IAP2 spectrum. For AusNet Services, we accept that in some areas there are implicit promises. But better practice would have these promises made explicit and for all key areas of the business

## 2.4 Conclusion on Consultation

Our criteria for assessing consumer engagement stated earlier is:

- previous consumer engagement,
- the process for consumer engagement in developing this regulatory proposal
- the extent to which consumer input has been heard and applied in developing this regulatory proposal.

Considering previous consumer engagement, we conclude that AusNet Services has made significant progress in seeking to apply consumer engagement principles and support them in continuing to apply the IAP2 spectrum as a best practice framework. Compared to previous consumer engagement, considerable progress is evident.

For this TRR, AusNet Services has made solid efforts to engage with end consumers, within a broader 'stakeholder' engagement rubric. Their progress in applying the first two levels of the IAP2 spectrum, 'inform' and 'consult' has been considerable and their goodwill in

seeking engagement, undeniable. In general, the two-way nature of consumer engagement is still developing

In applying consumer engagement to this TRR, there has been reasonable responsiveness to some capex and opex views of consumers, including the confidential pass through event. The major disappointment has been in rejecting strong consumer advice regarding accelerated depreciation.

We suggests The next challenge for all network businesses in applying the consumer engagement guideline, we opine, comes from a well-known training maxim of moving through the following four stages:

1. Unconsciously unskilled
2. Consciously unskilled
3. Consciously skilled
4. Unconsciously skilled

This suggests that the next step for AusNet Services, as indeed with most other in NSP's, is for consumer engagement to be overtly a two-way process and an ongoing and automatic part of the way the business operates. AusNet Services have moved rapidly from level 1. "Unconsciously unskilled" to levels 2 and 3, and currently operate at these levels, for different aspects of consumer engagement. Consolidating a consumer focus into all aspects of the business is the next stage, as AusNet services have very successfully achieved with safety considerations and practice.

# 3 Capital expenditure

AusNet Services has quite correctly pointed out in its proposal that its average annual transmission capital expenditure (capex) for 2017-22 is proposed to be 8% lower than its average annual capex for the previous regulatory period, 2014-17, in real 2016-17 dollars. However, this more moderate proposed capex is still 4% higher in real terms than expenditure for the earlier period of 2008-14, and 20% higher in real terms than the average annual expenditure (accepted as prudent by the AER) for the earlier regulatory period 2003-08.[2]

We reiterate the views expressed in the CCP's previous advice to the AER regarding the NSW electricity distributors that, 'considering the massive expenditure that has been incurred over the last decade, and having regard also to declining demand in large parts of the network',[3] capex should be declining. Rather than perpetuating the relatively high rates of capex that have been allowed over the previous two regulatory periods, we ask the AER to rigorously assess the proposed levels of expenditure and do everything in their power to bring the average annual expenditure back to pre-2008 levels.

The bulk of AusNet Services' proposed transmission capex is for asset replacement and for CBD station rebuilds. A large customer of AusNet has expressed concern to us about the amounts proposed to be spent on the designated projects, saying that even if the projects are necessary, the amounts being spent on them are higher than unregulated businesses might pay for similar engineering projects. Regardless of whether the AER has previously assessed these projects for prudency and efficiency, given most are large projects that have been in planning stages or under way for some time, they must now be re-assessed for prudency in the context of current technology capabilities and current demand.

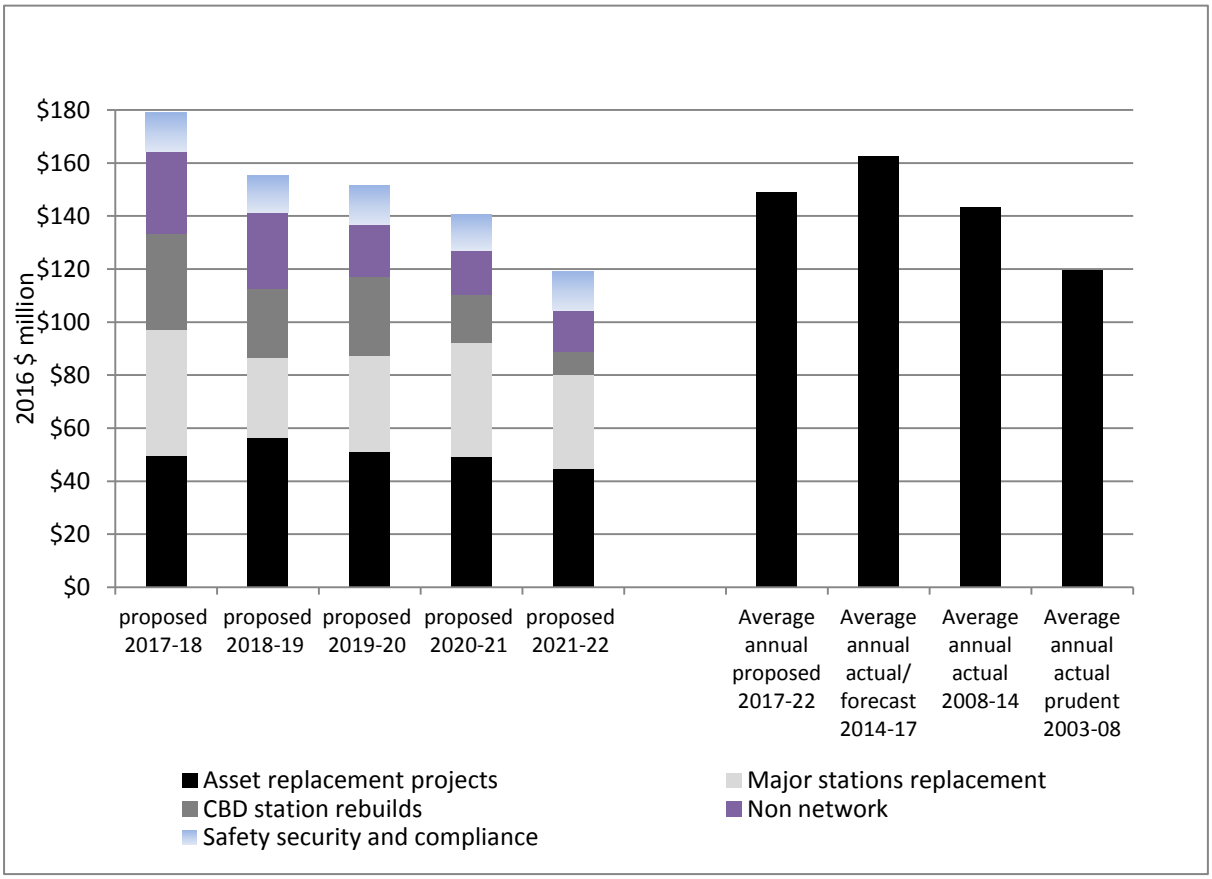
Figure 4 shows that the proposed expenditure for the upcoming regulatory period is greatest in 2017/18 and then declines over the period. The building block approach to calculating regulated revenue allows for an intra-period return on intra period capital expenditures, so there is a cumulative effect within the period as capital expenditure is added into the regulatory asset base and therefore the return of capital is affected. The cumulative effect on revenue within the regulatory period, affects prices faced by consumers, and consequently we urge the AER to look carefully at the timing of capital expenditures within the period 2017-2022. The proposed levels of capex will result in higher prices for consumers this period than a flatter structure over the regulatory period; we would prefer a structure that is least likely to result in a price shock at the end of the

[2] Data for 2003 to 2008 taken from table 2.2 in AER's Final decision for 2008-14 is available at https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/sp-ausnet-determination-2008-14. Table 2.2 in that report sets out $464.5m in nominal dollars spread over the period 1 January 2003 to 31 December 2008 that the AER considered prudent. This has been escalated using ABS CPI for all groups Australia annually from March 2002 to March 2015 and thereafter assuming 2.5% to June 2017. The CCP does not wish to get bogged down in the semantics of calculating the 2016-17 real value of these nominal amounts, but have provided this estimate to demonstrate what appears to be a significant increase in annual capital expenditures in the past three regulatory cycles.

[3] Consumer Challenge Panel (updated) - Subpanel 1 submission on NSW DNSPs regulatory proposals 2014-19 - 15 August 2014 available at https://www.aer.gov.au/about-us/consumer-challenge-panel/statements-and-advice#subpanel-1

period.[4]

Figure 4. AusNet Transmission Capital Expenditure




Source: Table 4.7 of AusNet transmission proposal for 2017-22. Data for 2003/04 to 2007/08 taken from table 2.2 in AER's Final Decision for 2008-14

The CCP does not have the resources to investigate the matters raised in this section of our advice in detail. These matters are important because once capital expenditure is added to the regulatory asset base it has a bearing on revenues for many years to come through the calculations for return of capital. We encourage the AER to investigate capital expenditure amounts and timing further, utilising their own expertise and that of their engineering consultants.

[4] We note that transmission businesses are not required to prepare Tariff Structure Statements. We suggest that these statements require a network business to have a disciplined view on how price impacts will affect customers. It may be useful to require transmission businesses to provide information about impacts, in the interests of lessening potential price shocks.

# 4 Benchmarking

"It is better to be roughly right than precisely wrong" – JM Keynes

The AER has advised that it will not use benchmarking to derive efficient expenditures for its regulated transmission businesses at this stage. Despite this, we wish to make some general comments about the importance of benchmarking in the hope that it will be possible to do so in future reviews.

## 4.1 Benchmarking is critical for regulation

The Productivity Commission released a major report on Energy Network regulation in June 2013[5] in which it observed that "rule changes introduced in late 2012 require the AER to undertake routine benchmarking and give it the discretion, though not the obligation, to use benchmarking in making price and revenue determinations." It went on to say that "although Australia has been relatively 'unsophisticated' in its use and application of regulatory benchmarking in the electricity sector, this is likely to change in coming years with improvement in the AER's data collection and modelling capabilities. An increase in benchmarking for diagnostic and informational purposes is likely in the near term, given recent AEMC Rule changes. Over time, repeated use of benchmarking models (as well as ex-post analysis) will improve the reliability of the models' estimation of network efficiencies, and increase the potential for them to have greater weight in regulatory decisions. Whilst there may be some shorter-term burdens for network businesses in providing additional data to the AER, improved confidence in benchmarking has the potential to simplify determinations and lower overall costs, leading to benefits for network businesses and consumers." This commentary reinforces the importance of benchmarking in electricity sector regulation.

The AER has now released two annual benchmarking reports on transmission businesses. While caution should be taken in drawing conclusions from the work done so far because of the limited data set available, the 2014 and 2015 benchmarking released by the AER[2] is a step in the right direction because it is starting to build up a picture of efficient costs. Benchmarking is a very useful and important tool for a regulator to use, and therefore it is the CCP's strongly held view that the AER should continue to develop robust benchmarking that may in future be used to set an efficient expenditure allowance for this monopoly business.

The CCP recognises the legitimacy of the use of benchmarking by regulators and applauds the AER for its efforts over the last few years. We are aware of three areas where the AER has put great effort into developing its benchmarking capability:

- The 2013 Better Regulation" program had a major 'stream' of work dealing with benchmarking with a substantial number of meetings involving network businesses,

[5] Productivity Commission Electricity Network Regulation - Inquiry report, 26 June 2013.

academics and consultants and consumer representatives to consider both benchmarking modelling approaches and 'category analysis', detailed consideration of specific aspects of categories to be benchmarked.

- The AER has also engaged academics/consultants with specific expertise in benchmarking and utilised their advice.
- The AER has obtained data from network businesses, through Regulatory Information Notices (RIN's), in a standardised form, during 2014 and 2015 through RINs, and has used this data supplied by the businesses to undertake its benchmarking work, which makes for highly comparable input data.

The AER has now released two annual benchmarking reports on transmission businesses.[6] While caution should be taken in drawing conclusions from the work done so far because of the limited data set available, the 2014 and 2015 benchmarking released by the AER is, in the eyes of the CCP making good progress, and uses a reasonable and appropriate methodology.[7]Benchmarking is a very useful and important tool for a regulator to use, and therefore it is the CCP's strongly held view that the AER should continue to develop robust benchmarking that may in future be used to set an efficient expenditure allowance for this monopoly business

## 4.2 Where AusNet Services sits within the AER's benchmarking

There is value in considering the recent benchmarking for transmission network businesses in Australia undertaken by the AER. Some summary data is reproduced in Figure 5 below.

Figure 5. Transmission Benchmarking for Australia, TNSP Outputs 2009–14 average

[6] Available at https://www.aer.gov.au/networks-pipelines/network-performance/annual-benchmarking-report-distribution-and-transmission-2015

[7] More discussion of the CCP's views on the AER's benchmarking is contained in the CCP's response to the AER's draft decision on the NSW DNSPs dated 16 February 2015, available at https://www.aer.gov.au/about-us/consumer-challenge-panel/statements-and-advice#general-advice

| | Circuit line length (km) | Energy transported (GWh) | Maximum demand (MW) | Voltage of entry/exit points (KV) |
|---|---|---|---|---|
| ElectraNet | 5,518 | 14,006 | 4,130 | 7,092 |
| Powerlink | 13,970 | 50,518 | 11,139 | 15,642 |
| AusNet Services | 6,573 | 48,334 | 9,370 | 10,380 |
| TasNetworks | 3,495 | 12,991 | 2,504 | 5,964 |
| TransGrid | 12,777 | 67,700 | 17,700 | 15,714 |

Source: AER Benchmarking report 2015

In general terms, this data means that AusNet Services is the median TNSP in Australia, larger than the smaller state TNSP's from South Australia and Tasmania, smaller that the NSW and Queensland networks servicing larger geographic areas.

Estimates of the cost to consumers of unsupplied energy, due to TNSP supply interruptions are shown in figure 6. This figure shows that AusNet Services is currently one of the best performing TNSP's, having been worst performing in 2012. The variability of performance, over time, for all transmission network businesses is worth noting.

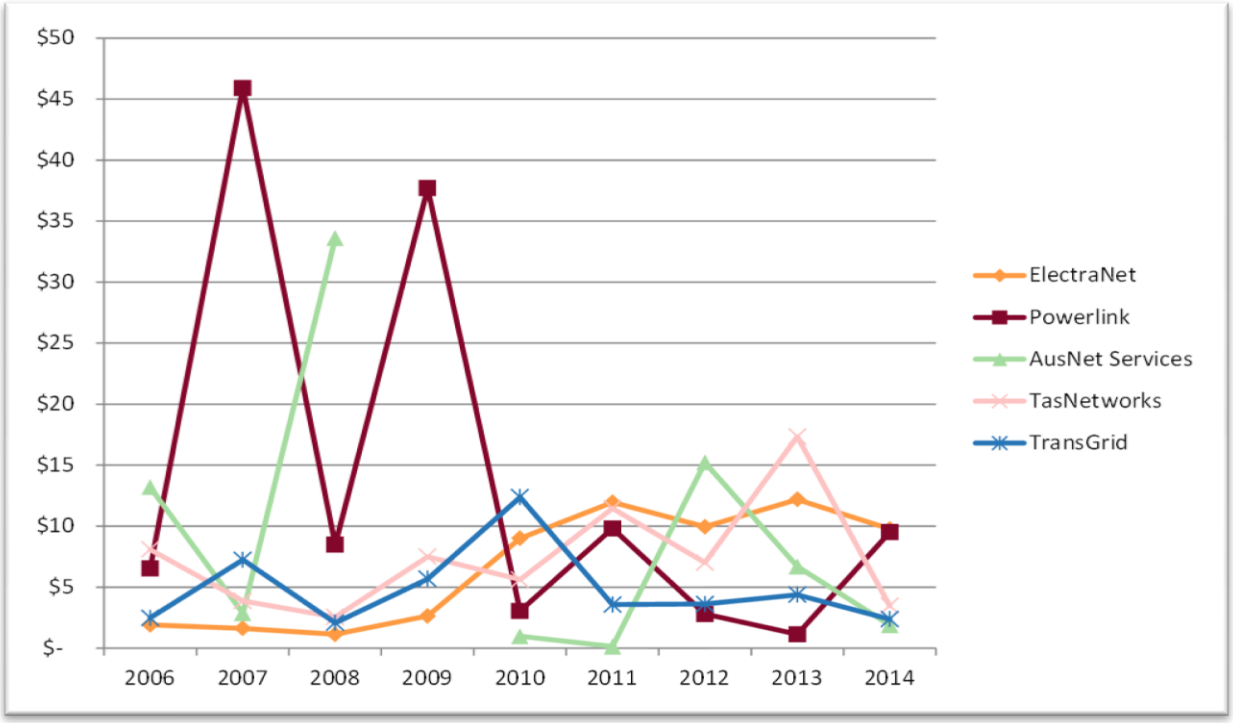
We believe that the current, 2014 results for this measure are encouraging for AusNet Services.

Another really important measure for considering efficiency of operation for transmission network businesses is multilateral total factor productivity (TFP). This is shown for the five Australian electricity transmission network businesses over the last nine years.

Except for the 'bad year' in 2009, AusNet Services has maintained relatively stable multilateral total factor productivity throughout the period with lower rates of decline over recent years than some other TNSP's, which have all experienced declines except for TasNetworks.

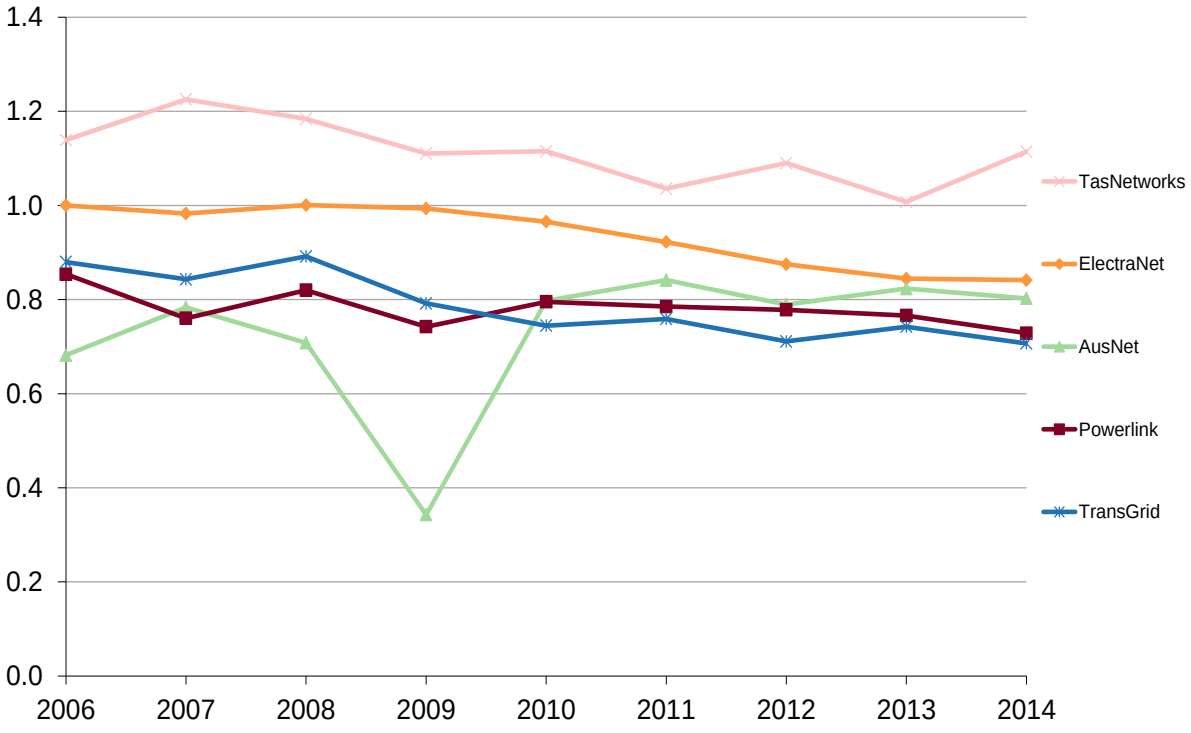
Multilateral total factor productivity is an indicator that should be a focus for improvement in the best interests of consumers, since this would mean that networks are being used more efficiently. We suggest that improving MFP remains a challenge for AusNet Services as with other TNSP's in Australia.

Figure 6. Estimated customer cost of energy unsupplied: interruptions ($million nominal)




Source: AER Benchmarking report 2015

Figure 7. Multilateral total factor productivity by TNSP for 2006–14




Source: AER Benchmarking report 2015

# 5. Opex

In considering operating expenses for AusNet Services, we recognise that the largest single element of opex for AusNet Services is the easement land tax, a requirement of Victorian legislation and consequently exogenous to AusNet Services. Consequently, 46% of the total operating costs are controllable for the business with the balance being the easement land tax. The total forecast opex for the TRR is shown in figure 8 below, showing both controllable and non-controllable opex forecasts.

Of most significance is the projected 13% increase in controllable opex for the TRR period. The two tables in figure 8 show actual and forecast opex for recent years is shown along with proposed controllable opex for 2017-22. The proposed opex starting in 2017-18 is appreciably higher than the trend regulatory allowance would indicate.

Of particular concern is the significant increase in the first year of the TRR period. We understand that there is a small reduction in the following couple of years and then returning to near 2017-18 levels for the last two years of the control period.

Figure 8

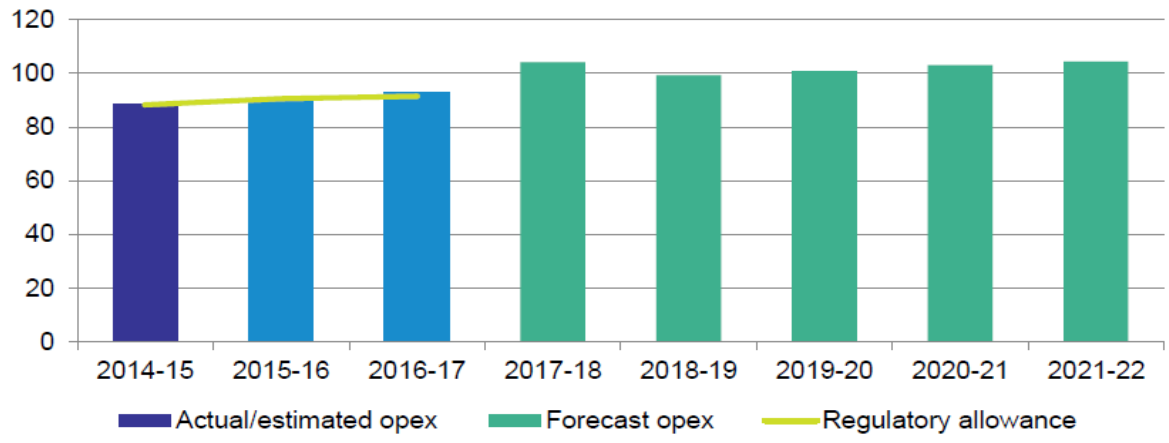
**Table 5.1: Total forecast opex ($m, real 2016-17)**

| Opex | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | Total |
|---|---|---|---|---|---|---|
| Controllable | 104.1 | 99.3 | 100.8 | 103.1 | 104.4 | **511.8** |
| Non-controllable | 118.0 | 118.0 | 118.0 | 118.0 | 118.0 | **589.9** |
| **Total** | **222.1** | **217.3** | **218.8** | **221.1** | **222.4** | **1,101.7** |

*Source: AusNet Services*

Of the total forecast opex, $576.4m, or around 52%, is easement land tax. Easement land tax is a levy applied by the Victorian Government, which is recovered through regulated revenues but does not represent the underlying costs of operating the network.

**Figure 5.1: Actual and forecast controllable opex ($m, real 2016-17)**




Source: AusNet Services TRR 2017-22

Figure 9 shows a declining forecast change for productivity over the TRR period which we believe is further reason for challenging the 13% proposed opex increase, a direct burden for end consumers. We suggest that there is capacity for improving productivity rather than increasing opex by the amount proposed.

Figure 9. Forecast Productivity

**Table 5.10: Forecast productivity change ($m, real 2016-17)**

| | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | Total |
|---|---|---|---|---|---|---|
| Productivity change (%) | 0.28% | 0.28% | 0.28% | 0.28% | 0.28% | |
| Productivity change ($) | -0.7 | -0.9 | -1.2 | -1.4 | -1.6 | **-5.8** |

Source: AusNet Services TRR 2017-22

Having considered proposed picks trend for the period, we now briefly consider “base” and “step” aspects of the generally applied: base – step – trend approach.

**5.1 Base Year**

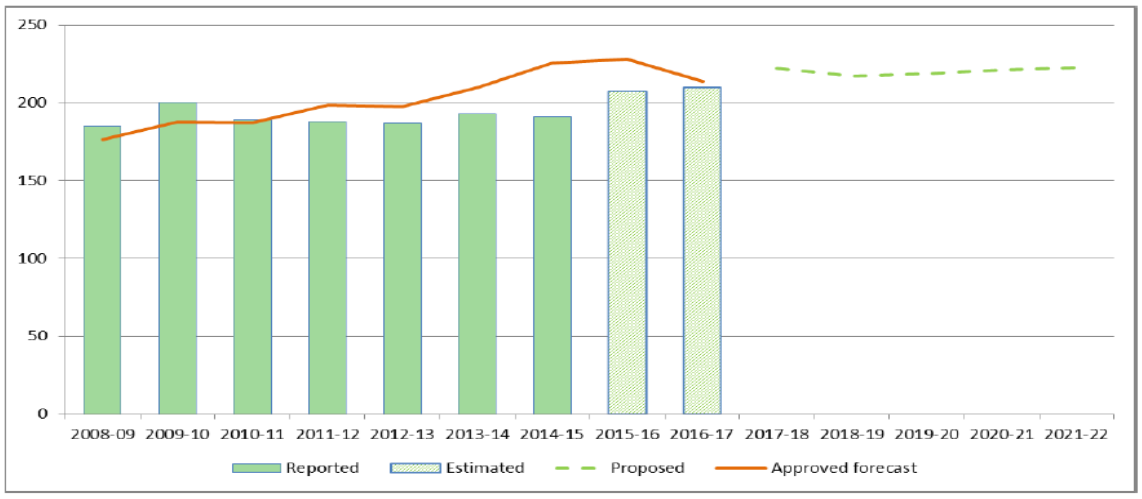
AusNet Services is proposing the year 2014-15 as the base year for the purposes of this regulatory control period arguing that it is the most recent full year of available operational costs and that starter has been independently verified and audited.

From figure 10, by inspection it is evident that the operating costs for 2014-15 are in line with the operating costs of years prior to this proposed base year. We accept that 2014-15 is a reasonable choice for base year for determining operating costs. We however challenge the assumption that the operating costs of this year are necessarily the most efficient costs, rather they are costs that are consistent with operating costs from previous years. We contend that there is not adequate evidence to suggest that the business has been operating at optimum efficiency for each of the years leading up to and including 2014-15.

Given the lack of more detailed data about the efficiency of 2014-15 opex, we accept that year as the base year for opex for 2017-22, noting that we believe there is room for increased efficiency in operating costs.

Figure 10. Opex, actual and proposed.

**Figure 10 Operating expenditure ($million, 2015–17)**




Source: : AusNet Services (SP AusNet), Economic benchmarking - Regulatory Information Notice response 2006–13, 2013–14, 2014–15; AER final decision PTRM 2008–14; AER final decision 2014–17 PTRM and opex model; AusNet Services, Regulatory proposal, 30 October 2015.

Source: AER Issues paper regarding AusNet Services TRR 2017-22

### 5.2 Step Changes

Regarding proposed step changes, AusNet Services say:

"A number of step changes have been included in the forecast:

- decommission some retired assets,
- roll out enhanced condition assessment technology to proactively manage capex levels (allowing the deferral of investment)
- address an evolving IT security and emergency response landscape. "

They present the data in table Z4 as further explanation of step change proposals

Figure 11. Proposed Step Changes

**Table 5.14: Forecast opex attributable to step changes ($m, real 2016-17)**

| Step change | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | Total |
|---|---|---|---|---|---|---|
| Establishment of IT security team | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | **3.3** |
| New emergency response arrangements | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | **1.0** |
| SAIP roll out | 0.3 | 0.3 | 0.1 | 0.1 | 0.1 | **0.9** |
| WMTS mobile switchboard | 0.7 | 0.3 | 0.3 | 0.7 | 0.1 | **2.0** |
| Synchronous condenser decommissioning | 4.3 | 0.0 | 0.0 | 0.0 | 0.0 | **4.3** |

Source: AusNet Services TRR 2017-22

The critical question in considering step change proposals is whether the element proposed is a significant change that is a step change, or whether it is simply a standard part of operation, which an efficient and prudent business would be operating in an ongoing manner.

We do not accept establishment of an IT security team is a step change nor are emergency response arrangements step changes, they are an ongoing operating expenditure of any business and consequently we challenge their inclusion as step changes.

Similarly we are not convinced that the costs of a new WMTS mobile switchboard are step changes either. We understand that this is replacement of current switch rooms and so is a cost that is simply covered by the depreciation of the old asset over time to enable replacement at the end of useful life, so a new mobile switchboard is simply a part of standard operating costs.

The smart aerial image processing (SAIP) rollout, on the other hand, we accept as a new expenditure and one that is reducing capital costs through more efficiently applying asset replacement capex dollars.

Finally the synchronous condenser decommissioning associated with the shutdown of the Morwell power station, is not a step change, being a foreseeable cost for which provision is made through ongoing depreciation, which is already been paid by end consumers.

We recognise that the shutdown of Morwell power station is a large event, but not unexpected. 'Large events' are a part of operating a transmission business and they occur periodically, for example the closure of the Point Henry Smelter was also a 'large event', but also a part of normal operations, over time, for a transmission business. Such events are part of normal operations, with assets depreciated over time to ensure the capital costs are returned to the business, so it is not a step 'change,' rather it is a standard operating cost.

We believe that AusNet Services has overstated the extent of step changes, and suggest that the only step change accepted by the AER is for the SAIP roll out.

### 5.3 Labour Costs

AusNet Services is seeking an increase of $13 million over the regulatory period, arguing that labour costs are increasing faster than CPI and citing the Construction Industry WPI index as a more appropriate labour costs escalator than the Electricity, Gas, Water and Waste Water (EGWWS) index, which is lower than the construction industry index.

We note that general wages growth is slow in Australia now and is likely to remain so for at least the next couple of years with sluggish economic growth. The Fair Pay Commission's minimum wage judgements have generally been to maintain real wages, ie adjust wages at CPI, or a little below.

The prevailing outlook for wages growth in Australia is for CPI at best. This will determine income growth for most end users.

We also note that the construction industry labour escalator is most likely factoring in the high housing costs and high property demand in Sydney, in particular, though also in some other cities. Meaning that high demand for construction pushes up construction income. These circumstances are unique to a part of the construction industry and are not applicable to energy businesses.

Consequently, we suggest that wages growth greater than CPI is out of alignment with much of the Australian labour market. Certainly the Construction industry multiplier is not reasonably applied to utilities. The EGWWS index is a more appropriate escalator, though we suggest that this index too is out of kilter with the prevailing wages climate in Australia.

**5.4 Insurance Costs**

The proposed increase in insurance costs proposed by AusNet Services is of concern, with nominal price increases proposed of 10% in 2017 and 2018 for liability by way of example. Given the general slow growth rates across the Australian economy, these rates of growth seem high and need to be fully tested by the AER.

AusNet Services also proposes a different methodology for calculating insurance costs as a category specific cost, insurance is about 6% of controllable opex. We are not convinced by this argument and propose that the AER maintain the approach of rolling forward base year premiums and continue to regard insurance costs as part of 'base' opex.

# 6. Accelerated depreciation

AusNet Services has proposed depreciation costs for 2017-22 that continue to apply straight line depreciation to existing assets (at the end of the current regulatory period 2014-17) and "introduce declining balance depreciation to accelerate the return of new assets from 1 April 2017 . . . [because] altering the timing of the recovery of depreciation charges is an appropriate regulatory response to addressing utilisation risk because it better matches cash flows with expected network use."[8]

## 6.1 AusNet Services has not demonstrated the impact of disruptive technologies on their business.

We do not deny that energy networks are facing changes to the way in which they are used because of changing customer behaviour and changing technology. We are of the view that these changes may result in some decreases in demand and usage, and some increases.

We recognise that it is difficult to predict when a technology that might be disruptive to conventional energy businesses such as AusNet Services' transmission might reach a scale that will impact on and challenge the existing way of providing energy to consumers. It is already apparent that technological innovations and therefore cost reductions in solar photovoltaics (PV) have lead to more consumers installing these and therefore reducing conventional grid use. It is intuitive that technological innovations will lead to cost-effective energy storage solutions either at consumer level or on the grid, which will reduce the need for capital investment by smoothing variability in power supply. The AER itself has recognised changes in the market, putting solar PV generation at 8% of total installed generation capacity in the NEM, and around 2% of electricity produced in the NEM, and noting that most of this had been installed since 2010. Installations vary from state to state, so the impact on AusNet Services' transmission business may be greater or less than this. Rooftop PV that is more attractive to consumers than conventional electricity will undoubtedly reduce consumer demand from the grid and therefore reduce demand for AusNet Services' transmission offerings.

Consumers appear to have reduced demand by using more energy efficient appliances, but this rate is harder to quantify. Constancy in networks' outputs no longer applies. In general the rate of increase or decrease in consumption is important in determining when 'machines' need replacing.

The AER also notes that in future "battery storage will allow for better matching of output from intermittent generation such as solar PV against evening demand peaks."[9] These two changes to AusNet Services' operating environment lead one to a feeling that the business' past business model might be impacted. However, none of these technologies is new, and

[8] AusNet Services transmission proposal page 175/332 and page 176/332
[9] Ibid

we surmise that a responsible business would have had regard to them over the past few years, as data has emerged.

In its proposal, AusNet Services has not established a nexus between the innovations that might give rise to very widespread adoption at some stage, when they are commercially viable, and AusNet Services' own transmission business. AusNet Services has not provided any concrete examples of how disruptive technologies are affecting or are likely to affect its transmission business. The main example provided in the submission relates to the closure of Point Henry smelter, which is an old customer that had been publicly identified as far back as 2012 as not financially viable following a comprehensive external review. AusNet Services provides text on why disruptive technologies are important and rates of take up. It describes the introduction of disruptive technologies such as the Tesla Powerwall, but does not connect its impact to the economics of AusNet Services' transmission business.

AusNet Services refers in its proposal to broker reports that refer to investors' "concerns with respect to utilisation risk."[10] However, brokers are also saying "[t]o date, we have seen little evidence of asset stranding for Australian networks."[11] Our view is that this is a legitimate conclusion by brokers, because there is no evidence of stranding. We agree with brokers' sense that there will be an impact, but until there is verifiable evidence of the extent of the impact then no adjustment to network business revenues.

Intuitively, changes in consumer habits and capabilities and changing technologies will affect an electricity network business. However, intuition is in our view insufficient reason to make a regulatory change such as that proposed. In any event, we feel that a responsible business would already have taken account of potential disruptors in its capex planning in the past. A thorough assessment of the impact backed by real evidence is necessary before a methodology change such as this can be justified by the AER.

## 6.2 Division of assets and proposed accelerated rate

It is not clear to us why AusNet Services has proposed different treatments for existing and new assets. We can surmise it is because to do so gives more regulatory certainty by maintaining the status quo on existing assets. It may also be simpler than altering asset lives for existing assets. It may be that this dilution of the impact would better result in a "modest"[12] acceleration. In any event, changes to usage of the network due to technological change and changing consumer demand affect the entire network, and consequently we see no reason to treat assets differently based on when they are acquired. Any approximation that treats the same types of assets differently just because of when they were purchased is flawed because it does not reflect potential for future use.

[10] Page 189 of 332 of proposal
[11] Page 189 of 332 of proposal
[12] Morgan Stanley Research, 27 February 2015, *Regulated Utilities RAB Season*.

AusNet Services' statement that "the proposed depreciation schedule will better align cost recovery with expected network utilisation, [and] encourage more efficient pricing signals in future periods"[13] is unjustified. It does not do this because the proposed depreciation is unrelated to the use of AusNet Services' invested capital. AusNet Services goes on to say that their proposal will "limit the extent to which capital is exposed to utilisation risk." This statement is true because capital expenditures in the future would be shielded by the accelerated depreciation and that will taint decisions about efficient expenditures, both capex and opex. However, it is not in consumers' best interests because it will not lead to lead to efficient investment decisions being made.

AusNet Services suggests a rate of 200% of the rates charged for existing assets, based on the Australian Taxation Office's (ATO) standard accelerated depreciation methodology that allows a tax deduction for depreciation of certain assets at twice the ATO's standard depreciation rate. The ATO's standard life often bears little resemblance to the economic life of an asset, and the accelerated rate bears even less resemblance. The ATO allows accelerated depreciation at a rate set by Government to encourage investment; it is simply an incentive that encourages businesses to invest by delaying corporate income tax payments. The ATO's 200% depreciation schedule is not a reflection of useful life of an asset and is applying a policy that is outside for the intent for natural monopoly regulation. It might be intuitive that disruptive technologies and changing demand will affect utilisation of transmission networks. Equally, to claim back the cost of investment in the network half as quickly again as in the past, may be a opportunistic reaction.

Our view is that

- the network's assets should be depreciated similarly by type and productive capacity, not by when they are purchased.
- a simple halving of the life of assets does not in any way reflect the timing of usage of these assets, and the AER should reject this simplistic approach.

## 6.3 Stakeholder views

Stakeholders have asked questions about the impact of disruptive technologies on AusNet Service' business. They have not supported accelerated depreciation. Despite this, the proposal has been made. No compelling reason has been provided to support the proposal.

It is arguably the most contentious part of AusNet Services' proposal for its transmission business, and stakeholders deserved to have had their views taken into account in a much more robust manner.

The AER should be less inclined to accept the proposal given that AusNet Services has sought feedback from consumers and made a proposal that is contrary to the feedback received.

[13] AusNet Services transmission proposal page 176/332

We refer to discussion in section 2 of this advice.

## 6.4 Depreciation in theory

Depreciation is the allowance that businesses set aside to cover a lessening utilisation capability on their fixed assets and properties. It is the making good of the continuous deterioration of a business' capital stock. Accounting standards refer to useful lives of assets[14] and to the cost of an item only being recognised as an asset if it is probable that future economic benefits associated with the item will flow to the entity.[15] They are clear that 'consumption of economic benefits' as the principle for recognising depreciation or amortisation, whereby the depreciation or amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity."[16]

Economic theory conceives that a business should take into account changes in the value of its capital assets, and the main consideration of this will be the extent to which its machines, buildings and the like have suffered depreciation or obsolescence over a period. The depreciation or obsolescence charge will include costs that would occur whether or not any output was produced, along with costs that are incurred by using the capital assets rather than keeping them idle. The latter can be manipulated by the business by determining what production levels should be set; but Australian monopoly electricity businesses are currently primarily volume-takers and consequently we see little reason to separate depreciation into fixed and variable components.

Businesses that do not fully allow for depreciation of their assets before they consume more will be consuming their capital, and they will be reducing the value of their assets. By depreciating too fast, a business that is subject to competitive market forces might be considered financially conservative, because it is setting aside more than is necessary to keep its capital intact. However Australian energy businesses are not subject to competitive forces and without appropriate regulatory intervention may be in a position to retain funds through accelerated depreciation that inefficiently recompense it for poor investments.

Depreciation, in theory and in principle applies consistent asset usage charges across all generations using long term assets. Rigorously applied, accelerated depreciation is likely to send better cost reflectivity signals to consumers, and that is in the better interests of the community. However, great care would need to be taken to ensure whole of network impacts are included, and that both longer and shorter lives are adjusted for, so that a two-

[14] For example AAS4, available at http://www.aasb.gov.au/admin/file/content102/c3/AAS04_8-97.pdf
[15] AASB 116, available at http://www.aasb.gov.au/admin/file/content105/c9/AASB116_07-04_COMPjun09_01-09.pdf
[16] Clarification of Acceptable Methods of Depreciation and Amortisation (Proposed amendments to IAS 16 and IAS 38) available at http://www.ifrs.org/Current-Projects/IASB-Projects/Depreciation-and-Amortisation/Exposure-Draft-and-comment-letters-%5BDec-2012%5D/Documents/ED-Clarification-of-Acceptable-Methods.pdf

way movement in average lives results. Both accelerated and decelerated depreciation are, in our view, equally likely, depending on projected asset use.

We do not doubt that efficiency signals will be better if depreciation more accurately reflects how assets are being used. We refer to the multi factor productivity discussion in section 4 and note that if the network is being used less, it may last longer and so, overall, decelerated depreciation would apply,

## 6.5 Other regulated network businesses' proposals and AER responses

Recently, Australian Gas Networks (AGN) proposed accelerated depreciation with reasoning as follows:

- The AERs' benchmark credit rating requires certain credit metrics to be achieved
- Achieving those metrics requires a certain level of revenue
- That revenue will be achieved by increasing one or other of the revenue building blocks, either
  - Return on capital, via a higher rate of return than the AER had previously contemplated, or
  - Return of capital, by front-ending depreciation through accelerating the time over which capital is returned

We note that the AER rejected AGN's proposal in its November 2015 Draft Decision.[17]

The AGN proposal differs significantly from that of AusNet Services for its transmission network, as it is based on finance-ability rather than the changing technological environment within which the business operates. It therefore has little bearing on the AusNet Services proposal, but is summarised here because it demonstrates the range of rationales being put forward for accelerating the rate at which capital invested should be returned to the business.

In April 2015, AusNet Services proposed accelerated depreciation for its Victorian distribution business. The proposal was to accelerate depreciation on a relatively small group of assets that were being replaced due to new safety requirements. The AER has largely accepted this proposal.[18]

The real relevance to this advice is that the proposal for accelerated depreciation is so different to that for this business, despite common ownership and operational control. It is unclear to us why AusNet Services' electricity distribution business is not facing any risk to asset utilisation from changing technology and demand, while the electricity transmission

[17] Available at http://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/australian-gas-networks-sa-%E2%80%94-access-arrangement-2016%E2%80%9321

[18] Proposal by AusNet Services and AER decision are available at http://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ausnet-services-sp-ausnet-determination-2016-20/revised-proposal

business that operates in the same area is facing sufficient risk to require compensation through revenue.

With regard to recent proposals by other electricity distributions businesses operating in the Victorian market,[19] we note that none has made a claim for accelerating depreciation due to the effect of disruptive technology in their market.

We wonder hy it is that in less than a year, AusNet Services has identified a risk for its transmission business that it did not foresee for its distribution business in the same area of operations.

South Australian Power Networks (SAPN) proposed in October 2014 that existing assets would be depreciated over their remaining asset lives averaged by asset class, and new assets depreciated according to a standard life for each asset class. The AER did not allow the simple average proposed by SAPN for existing assets, preferring a weighted average remaining life per asset class. The AER's view was that simple averaging consistently underestimated remaining asset lives, while the weighted average better reflected the nature of the assets over their economic lives. The AER accepted that while it might be most accurate to track each asset's remaining life, that would be onerous on the business, and would likely make revenues more volatile, and therefore combining assets into classes and then determining an average remaining life for each asset class at each rest, would be an acceptable proxy. SAPN responded with a proposal that separated old (purchased pre-2010) and new assets (purchased from 2010 to 2015) but then grouped assets within those separated periods. The AER accepted this approach, saying, "Given that the revised approach more accurately tracks the economic life of assets, it is consistent with the requirements of the NER."[20]

This decision is pertinent to the AusNet Services proposal because it demonstrates that remaining asset lives are critical to determining return of capital. In fact, it lags return of capital because the remaining asset lives are determined only at each reset, and requires a catch up if the remaining life has changed by more than the regulatory period during the course of that regulatory period. Lives might have changed to longer or shorter, and therefore depreciation may be shorter or longer. The AER's decision remains contentious because the methodology to determine a pool of assets' remaining life requires arbitrary assumptions; this advice will not enter into that debate.

There is no economic reason for scrapping a machine because it is old or of retaining a machine because it is new. What matters are its costs of production and productivity,

[19] ie Jemena, Citipower, Powercor and United Energy, available at http://www.aer.gov.au/networks-pipelines/determinations-access-arrangements?f[0]=field_accc_aer_sector%3A4&f[1]=field_accc_aer_segment%3A10&f[2]=field_accc_aer_region%3A15

[20] P13, available at http://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/sa-power-networks-determination-2015-2020

rather than its age. Consequently, a periodic re-assessment of future productive life, across the entire network makes economic sense. Estimates of future production and productivity cannot be precise, but an informed estimate at the length of time that the asset will be productive is possible.

Our view is that the utilization rate and remaining asset lives should be looked at network-wide, as cherry-picking individual asset groups from time to time will not allow for the inevitable increases and decreases in lives, that might occur across the whole system.

We recommend the AER investigates the benefits and disadvantages of setting remaining asset lives for depreciation purposes at each reset. There are several disadvantages to an ex post review of asset lives at each reset as to whether there has been a change in the expected remaining life of an asset:

- There will be more volatility in revenue than if straight line depreciation was used
- There will be greater regulatory uncertainty for consumers
- There would be substantial difficulties in executing this approach, in setting realistic lives

Despite this, we are of the view that efficiency signals will be better if depreciation more accurately reflects how assets are being used. Remaining asset lives will be affected by technological changes and demand changes during the period. Theoretically, there would be acceleration and deceleration of depreciation, because some remaining asset lives would be lengthened and some shortened.

## 6.6 Benchmark depreciation rates

In general, return of capital has been calculated using real straight line depreciation, at specified rates for asset classes, since the building block methodology was adopted in Australia.

We understand that largely the same asset lives and therefore rates have been applied within each business since regulation began. We are also aware that there are significant inconsistencies in the asset lives used for similar assets, by businesses regulated by the AER.

Benchmark lives would largely be redundant should the AER decide to adjust remaining asset lives at each reset. Benchmark remaining lives would, however, be of importance. It may be possible to work out average benchmark lives based on data coming through the RINS, and to use this in ascertaining benchmark remaining lives to reduce uncertainties for consumers, and the ability for businesses to game to their benefit, resulting from variations between businesses.

## 6.7 How to reflect risk

AusNet has submitted that if an adjustment to its revenue stream through its 'return of' capital is not allowed, then it will seek an adjustment through its rate of return.

The rate of return derived from the CAPM (which is the AER's preferred rate of return methodology) is designed to be a measure of the risk that cannot be eliminated by diversification through investing elsewhere. This systematic risk is measured by the business' beta, which captures the extent to which this business' risks are likely to vary more or less than a portfolio of investments across the market. Non-systematic, or diversifiable, risk can be diversified away by owners of the business and accordingly are not recognised in the rate of return.

The AER should not allow any adjustment for this risk through AusNet Services' rate of return.

## 6.8 Conclusion on AusNet Services' proposal

We contend that the link between disruptive technologies and risk to AusNet Services' transmission business has not been adequately demonstrated by AusNet Services. The impact on the business' line usage is unclear. AusNet Services' proposal is incomplete and not fully specified, and therefore the AER should not accept it. Given the lack of evidence, our view is that an adjustment to AusNet Services' revenues is inappropriate at this stage.

There are consistent and competing factors in getting to the best long term interests of consumers.

In the past, demand for electricity has risen constantly. We now find ourselves in a world where demand, both peak and usage, is not increasing as fast as it has in the past. Fluctuations in activity in the electricity market must be recognised and accounted for in an evidence-based and methodical way. Consumers' long term interests will only be met if the AER determines that revenue and tariffs respond to environmental changes in a methodical and evidence-based manner.

# 7. Incentive schemes

Incentive schemes for both operational performance and expenditure efficiency will apply to AusNet Services in the 2017-22 regulatory control period. These are:

- STPIS, Service Target Performance Incentive Scheme, which provides incentives to maintain or improve operational performance. Also through the NCIPAP: The Network Capability Incentive Parameter Action Plan. AusNet Services proposes "two priority projects to improve network capability, building on the seven projects successfully delivered to date which have created net benefits of $34m."
- EBSS, The Efficiency Benefit Sharing Scheme which provides incentives to achieve and maintain operating expenditure efficiency improvements; and
- CESS, The Capital Expenditure Sharing Scheme which provides incentives to make capital expenditure efficiency gains.

## 7.1 STPIS

AusNet Services has confirmed that it will apply the latest version: version 5, of the service target performance incentive scheme which provides financial reward for the NSP if service performance is better than target, or a return to consumers if service performance is worse than target.

We note the various performance outcomes since 2010 for 6 service target performance areas as presented by AusNet Services in their TRR. These are shown as figure 12, a collection of six performance measures.

We observe that only in one of the six performance areas, unplanned outage circuit event rate – transformers (forced outages) that performance actually meets target the other five areas the most recent results that is the 2014 target performance levels have not been met. We suggest that this means that both AusNet Services and the AER will need to monitor closely the application of STPIS during the regulatory period to ensure payments are generally provided for improved service against target.

Network capability incentive parameter action plan (NCIPAP)

Since the projects to be considered under the NCIPAP must be approved by AEM0 and in accordance with essential services commission of Victoria guidelines, and these criteria have been met, then we accept the project proposed for inclusion under the NCIPAP for 2017-22

Figure 12: Service Target Performance

**Figure 7.1: Unplanned outage circuit event rate – lines (fault outages)**

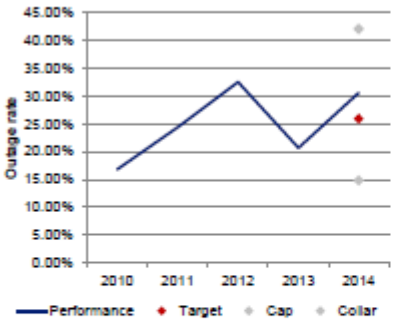



**Figure 7.2: Unplanned outage circuit event rate – lines (forced outages)**

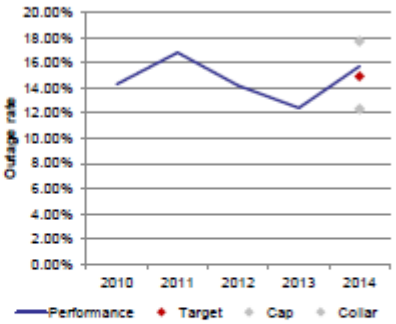
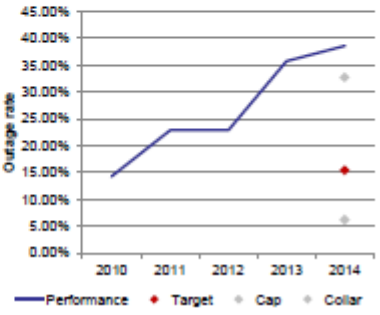



**Figure 7.3: Unplanned outage circuit event rate – transformers (fault outages)**


**Figure 7.4: Unplanned outage circuit event rate – transformers (forced outages)**


**Figure 7.5: Unplanned outage circuit event rate – reactive plant (fault outages)**


**Figure 7.6: Unplanned outage circuit event rate – reactive plant (forced outages)**




Source. AusNet Services TRR 2017-22

## 7.2 EBSS

AusNet Services has said that they will apply the new EBSS arrangement proposed by the AER for the 2017-22 regulatory period,. We accept this general arrangement.

AusNet Services has proposed three exclusions for the EBSS, namely self-insurance the easement land tax and the cost of priority projects approved under the network capability component of the STPIS.

We accept the easement land tax as a pass through and therefore a logical exclusion and similarly the cost of priority projects are appropriate exclusions as they are covered elsewhere in the STPIS arrangements.

However we are not convinced about excluding self-insurance. Insurance costs are a standard part of the costs of any business and should be managed efficiently, with the business balancing costs with benefits and risk.

We think that insurance costs should be part of the EBSS

Regarding the treatment of debt raising costs, the CCP supports the application of debt raising costs using the current AER benchmark methodology, we not consider this to mean that debt raising is excluded from the EBSS.

## 7.3 CESS

The CCP supports the application of CESS for the regulatory control period 2017-22, as proposed by the AER in the framework and approach for this TRR, we note that AusNet Services also supports the application of the capital expenditure sharing scheme

# 8. Return on Investment

We note that other networks regulated by the AER have appealed to the Australian Competition Tribunal on some of these issues, and that a decision that is pending to be made by that Tribunal might influence the AER's decision for AusNet Services TRR 2017-22. The AER might decide to accept an exogenous setting of rate of return parameters by the Tribunal and apply the Tribunal's decision to AusNet Services transmission determination. It might decide to exercise its discretion and apply its own parameters. In any event, we briefly set out below our views on an appropriate rate of return for AusNet Services transmission that best meets the long term interests of consumers, cognizant that these debates have been thrashed out, at length over the last couple of years.

## 8.1 Rate of return

The AER's December 2013 Guideline on Rate of Return sets out the AER's preferred methodology for calculating this input to the revenue build-up.[21] The process for establishing the Guideline was rigorous and inclusive. As part of the year-long 2013 Better Regulation program conducted by the AER, network representatives, consumer groups and other stakeholders spent considerable time discussing and debating to produce the Better Regulation Guidelines, including the Rate of Return Guideline.

We concur with the AER's statement that "certainty and predictability of outcomes in rate of return issues could materially benefit the long term interests of consumers."[22] Cherry picking of parameter sources by network businesses to derive the highest rate of return from time to time is not in the long term interests of consumers.

We are of the view that a decision made by the AER within the framework set out in its Guideline could meet the long term interests of consumers as long as the AER uses its judgment to set parameters that result in the lowest possible rate of return. If the AER applies its Guideline, the rate of return that results will be a reasonable outcome for consumers.

AusNet Services transmission's proposal digresses from the Guideline in a number of areas, which are set out in tables 10.2 and 10.3 of its proposal. Its proposed cost of equity of 10.03% is derived from an average of four models, and even its calculation of cost of equity using the Sharpe Lintner model – the AER's preferred model – uses parameters outside those in the Guideline and results in a cost of equity value in the range 9.48%[23] to 10.03%.[24] AusNet Services' proposed cost of debt of 5.37% is based on BBB rating and 10 year maturity, RBA only, and substantially complies with the AER guideline. With gearing of 60%, the resulting proposed rate of return is 7.22%.

[21] Available at https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/rate-of-return-guideline
[22] Section 8.3.2 of each of AER's November 2014 Draft Decisions on NSW distribution network businesses
[23] Risk free rate 3.02% and risk premium component of 6.46%
[24] Risk free rate 3.02%, MRP 7.91%, and equity beta 0.886

Our view is that the rate of return proposed by AusNet Services for its transmission business will provide excessive returns to AusNet Services, to the detriment of consumers who must fund this cost through excessive electricity prices.

The CCP has previously advised the AER of its concerns that Australian network businesses earn excessive profits, not in some small part from the return on equity that the AER has allowed.[25]

The AER's October 2015 fact sheet on rate of return provides an indicative preliminary decision for AusNet Services of 6.10%, based on gearing of 60%, post tax cost of equity of 7.5% and pre tax cost of debt of 5.30%. In its November 2015 Draft Decision for Australian Gas Networks[26], the AER allowed a rate of return of 6.02%, based on gearing of 60%, post tax return on equity of 7.3%[27] and pre-tax return on debt of 5.16%. The rates being set by the AER are lower than that proposed by AusNet Services, but we suggest the rate could be lower.

Even within the Guidelines, the AER could still set a lower return on equity by specifying a market risk premium of 6.0 or below and an equity beta closer to 0.4 than 0.7. Point estimates for these parameters that are within the AER's range but lower than those set by the AER to date would be more in the long term interests of consumers while still meeting investors' rights to an adequate return on capital invested. Using the AER's most recently applied risk free rate of 3.02% in conjunction with a market risk premium of 6.0 and 0.4 would result in a cost of equity of 5.4%.

The approach taken by the AER to measuring the cost of debt is acceptable to us at this time. Using the AER's most recently applied cost of debt of 5.37% in conjunction with a cost of equity, it is our view that the rate of return that is in the best interests of consumers would be 5.4%.

We urge the AER to use the discretion given under the National Electricity Law, to set a rate of return, including cost of equity, which is in the interests of consumers as well as best meeting the rate of return objective. Our view is that lower rates of return would adequately recompense shareholders, who have enjoyed what we consider to be undue levels of profitability over recent regulatory periods, which has unacceptably impacted on prices paid by consumers.

As set out in section 3 of this paper, it is our view that whatever risk associated with disruptive technologies that might be faced by AusNet Services transmission is appropriately

[25] Smelling the roses and escaping the rabbit holes: the value of looking at actual outcomes in deciding WACC. Prepared for the Board of the Australian Energy Regulator, July 2014, Consumer Challenge Panel available at https://www.aer.gov.au/system/files/CCP%20report%20prepared%20for%20AER%20Board%20-%20Rate%20of%20Return.pdf

[26] Available at https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/australian-gas-networks-sa-%E2%80%94-access-arrangement-2016%E2%80%9321

[27] Risk free rate 2.76%, MRP 6.5%, equity beta 0.7

dealt with in the annual 'return of' capital calculation (or depreciation) within the building block approach, and not in the rate of return.

## 8.2 Gamma

Gamma is a regulatory complexity unique to Australia because of our tax credit imputation system. The National Electricity Rules require the AER to estimate a value for imputation credits, or gamma.

There are a range of arbitrary assumptions that must be made to calculate gamma – the benchmark company's effective tax rate and payout ratio, and the benchmark shareholder's domicile and Australian tax status and tax situation. Both AusNet Services and the AER have attempted to use data to derive gamma; we suggest these are not necessarily any more accurate than a guesstimate, because of the assumptions that must be made.

An added complexity that makes setting a benchmark gamma an even more arbitrary estimate is the interrelationship between corporate tax payments and gamma. Imputation credits only arise when tax is paid. Under the regulatory framework, the benchmark tax allowance is applied to the estimated taxable income derived from the building blocks, which is then discounted by the benchmark imputation credit value. The benchmark tax allowance set by the AER is, at the corporate tax rate of 30%, higher than actual tax rates. The degree to which it is higher is difficult to determine, as that would require disentanglement of regulated taxable income and tax paid (not tax payable) on that, from unregulated income and tax, for the benchmark businesses.

Because of the arbitrary assumptions that must be made, we are of the view that there is no right formula that can be applied to calculate this input, and that the AER must exercise judgment and use its discretion in setting this parameter.

AusNet Services proposes a gamma of 0.25. The Guideline estimates a gamma of 0.5, however in recent decisions the AER has departed from the Guideline and used 0.4. We can see no clear reason for a further downward departure from this Guideline.

A lower gamma unnecessarily increases the revenue allowance and accordingly increases prices faced by consumers. It is in the better interests of consumers to have a high gamma, so a gamma closer to 1 better meets the interests of consumers and better meets the NEO.

Our view is that gamma should be at least 0.5 because a higher gamma better meets the NEO, and because of the imprecision around estimating this input to the revenue calculation.

# 9. Confidential pass through event

A pass-through event must not be allowed lightly, given that the costs of pass through events are assessed in isolation from other costs of the network business and there is limited opportunity for stakeholder input at the time the event is triggered. Customers are entitled to a large degree of certainty in the prices they will pay that are set by the regulator at the time of each review. Intra-period price rises by stealth defeat the processes set out in the National Electricity Rules that allow consumers to express opinions that are part of the balancing and assessing by the AER of a package of costs in each regulatory proposal.

A pass-through mechanism should pass through only the material, incremental, efficient costs associated with defined events. The network must have every incentive to limit or mitigate the costs associated with a pass-through event.

AusNet Services has nominated six pass through events for its transmission business, and has provided no public information about one of these events, over which it has claimed confidentiality.[28] We have seen the confidential version of the AusNet Services proposal and agree that the event is commercially sensitive in nature, and that the wider public should not see that detail. However, it is our view that the onus remains with AusNet to show the AER that including it as a pass-through event is in the long term interests of consumers, regardless of confidentiality.

It is our view that as a matter of process, it is not in consumers' best interests to face a pass through event - which by its very nature is full of unknowns and therefore should be treated with caution by a regulator - that is confidential and therefore has an added layer of unknowns.

It is our view that it is beyond the mandate of the AER to make a decision on behalf of consumers about whether the event should be included and whether the proposed wording is in the best interests of consumers. AusNet Services must be accountable to consumers on this issue, and cannot rely on the AER to assess whether the proposed definition and the range of scenarios that might lead to the event occurring are in consumers' best interests.

AusNet Services has advised that it raised the issue of confidentiality over parts of the proposal with stakeholders at its October 2015 stakeholder forum. In its proposal, it says that it "is open to disclosing the details of the proposed event to stakeholders on request, subject to suitable confidentiality agreements being put in place."[29] AusNet Services has recently advised us that some major users and their representatives have availed themselves of this and have scrutinised the detailed wording of the proposed pass through clause. We do not yet know whether these consumers will make submissions to the AER on this issue. We hope they do, as they are well placed to understand the implications of the various scenarios that might play out.

[28] Chapter 12.2 of the AusNet proposal, at page 312/332
[29] 12.2 of the proposal, on page 312/332

As it stands, AusNet Services has identified more than one scenario that might occur in the event that the pass through event occurs. To some degree, the change in amount and nature of costs that would result should this pass through event occur would be outside the control of AusNet Services, although they will be obliged to negotiate and therefore will have some input to the level and type of additional costs incurred through the scenario that eventuates. Our view is that it is in the best interests of consumers that AusNet Services has strong incentives to achieve an efficient and prudent outcome, so that the scenario that does eventuate is the best one for consumers in the long term. At this stage, we will not express a view on which of the identified scenarios is in the best interests of consumers, but ask the AER to assess the proposal in the context of the incentives faced by AusNet Services.

Our view is that it would be in consumers' best long term interests if AusNet Services absorbs the costs associated with the proposed pass through event for the 2017-22 regulatory period, unless:

- at least one major user has made an informed submission to the AER on the issue, and the AER has taken that submission into account, and
- the AER is satisfied that AusNet Services has strong incentives to achieve an efficient and prudent outcome.

The event over which AusNet Services claims confidentiality is a non-systematic risk, and consequently is best reflected in expenditures rather than rate of return. This point is discussed in more detail in section 8 of this advice.