CCP Sub Panel 3
c/- CCP Secretariat, AER

23 May 2014

Mr Paul Dunn
AER

cc VICelectricity2016@aer.gov.au

Dear Paul

At the recent SP3 meeting on 14 May 2014 we had with you, the SP commented that it had some concerns about the F&A that the AER is intending to release as a preliminary position.

The following confirms the concerns SP3 has with the AER preliminary position for the F&A. SP3 considers that the following three points should be stressed in the preliminary position document by the AER.

1. SP3 notes the observations by the AER that the WAPC approach has resulted in DNSPs *consistently* achieving revenues above their revenue allowances, to the disadvantage of consumers. Importantly, it also notes that this observation has not been challenged by the DNSPs. The AER has also noted that claimed benefits of the WAPC (the introduction of more efficient network pricing and increasing the utilisation of networks) have not been observed in practice, and that the balance of consumers interests lie with applying a revenue control approach across all DNSPs.

   SP3 considers that as part of the draft F&A, the AER should stress that the WAPC approach presents a considerable concern to consumers as its operation can allow systematic recovery of more revenue than considered appropriate by the regulator, a trend exacerbated by information asymmetry between the DNSPs and the regulator and consumers.

   SP3 also considers that the draft F&A should specify a single form of the control mechanism to apply in a given region as the arguments in favour of the revenue control mechanism apply equally to all the DNSPs operating in the same region. This point is specific as SP3 has concerns that one or more of the DNSPs in the Victorian region might seek a WAPC form of control while the others accept a revenue cap control.

   In promoting the revenue control mechanism, SP3 recognises that the revenue control mechanism transfers the risk of consumption variation from the DNSPs to consumers. This highlights the importance of the AER improving its forecasting capabilities for opex and capex, particularly given the increased discretion under the revised National Electricity Rules for the AER to reject a forecast and replace it with its own.

2. In relation to the incentive schemes applying to allowed capex (CESS) and opex (EBSS), SP3 observes that while the incentive schemes should lead to better outcomes for consumers in the long term, this benefit only applies when the allowances for capex and opex are set at the most efficient levels. Specifically, capex and opex allowances that are higher than the most efficient levels will bias the incentive scheme in favour of DNSPs. SP3 has a concern that the DNSPs will seek to limit the use of the AER tools.

   SP3 considers that the AER must use all of the tools it has available to ensure the allowances for capex and opex are set at the efficient level and should make it clear in the F&A that the AER will use all of the tools available to achieve this outcome.

3. SP3 is most concerned that the consumer engagement conducted by the DNSPs is meaningful and has focus on the key challenge of ensuring consumers understand both the costs and the benefits of the DNSPs' expenditure proposals. SP3 will be closely monitoring the DNSP's consumer engagement approach and material in order to form a view on the effectiveness of this aspect of consumer engagement.

   SP3 considers that the AER should include in its preliminary position on the F&A, that this is what both it and SP3 will be doing.

Yours sincerely
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