



Department of Primary Industries

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Our Ref:

Dear Mr Pattas,

Re: Further submission on the Victorian electricity distribution network service providers' regulatory proposals for 2011-15

On 18 August 2010 the Minister for Energy and Resources provided a submission on the Australian Energy Regulator's draft determination on the revenue for the Victorian electricity distribution network service providers' (DNSPs) for 2011-15 and the DNSPs' revised regulatory proposals.

The submission expressed concerns about the methodology foreshadowed for rolling depreciation into the regulatory asset base for the 2016-20 regulatory control period.

We are concerned that the Australian Energy Regulator is not protecting the interests of consumers by moving from an approach in which regulatory depreciation is rolled forward into the regulatory asset base to one in which actual depreciation is rolled forward into the regulatory asset base.

Many components of the building block revenue are determined through forecasts with DNSPs (and customers) bearing the risk of variances between actual and forecast.

By rolling forward the regulatory asset base using regulatory depreciation, neither the DNSP or customer is bearing the risk of the variance between forecast and actual depreciation. However, if the regulatory asset base is rolled forward by using actual depreciation, the DNSP and customer bear the risk of the variance between forecast and actual forecast. There does not appear to be any compelling case to introduce this risk.

If actual depreciation is rolled forward into the regulatory asset base, the DNSP will over recover depreciation and customers will effectively pay more than they would otherwise when the actual depreciation is less than the regulatory depreciation and where actual depreciation is greater than the regulatory depreciation the DNSP will under recover depreciation and customers will benefit.

If regulatory depreciation is rolled forward into the regulatory asset base, the distributor will neither over recover or under recover depreciation.

This is illustrated through a simple example.



	Actual depreciation rolled into the regulatory asset base	Regulatory depreciation rolled into the regulatory asset base
Opening asset base	2500	
Regulatory depreciation	250	
Building block revenue – period 1	Includes regulatory depreciation of 250	
Example 1: Regulatory depreciation greater than actual depreciation		
Actual depreciation	200	
Closing RAB	2300	2250
Building block revenue – period 2	Includes return on and return of the opening RAB of 2300	Includes return on and return of the opening RAB of 2250
Example 2: Regulatory depreciation less than actual depreciation		
Actual depreciation	300	
Closing RAB	2200	2250
Building block revenue – period 2	Includes return on and return of the opening RAB of 2200	Includes return on and return of the opening RAB of 2250
Conclusion	The amount that customers pay in the subsequent period is dependent on whether actual depreciation is more or less than regulatory depreciation	DNSP and customer no better and no worse off regardless as to whether the actual depreciation is more or less than regulatory depreciation

As indicated in the Ministerial Council on Energy's Standing Committee of Officials' response to stakeholder comments on the Exposure Draft of the National Electricity Rules for distribution revenue and pricing, the appropriate process to determine whether actual depreciation or regulatory depreciation should be consistently applied in all determinations is through a rule change process.¹

The AER should therefore not pre-empt a potential future rule change regarding rolling depreciation into the regulatory asset base and should reconsider whether it is appropriate to roll in actual depreciation rather than regulatory depreciation into the regulatory asset base given the circumstances that apply in Victoria.

Should you have any queries in relation to this submission, please do not hesitate to contact me on 9658 4793.

Yours sincerely,



Mark Feather
 Director, National Energy Development
 12/10/10

¹ SCO response to stakeholder comments on the Exposure Draft of the National Electricity Rules for distribution revenue and pricing, page 57