11 September 2012

Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

By email to: ElectraNet.2013@aer.gov.au

Dear Sir/Madam

**ECCSA response to ElectraNet Pass Through Proposal**

The Energy Consumers Coalition of SA (ECCSA) is affiliated with Major Energy Users (MEU) and this response is made on behalf of ECCSA.

The ECCSA notes that the pass through provisions proposed by ElectraNet amplify what have been previous assessments by the AER regarding pass throughs (reducing risks to the service provider) and insurance costs (included in the opex allowance) and the balancing of costs, risks and rewards in the regulated revenue. The ECCSA also notes the recent Competition Tribunal decision in relation to the SP Ausnet exposure to the class action associated with the 2009 bushfires in Victoria where the Tribunal has extended the pass through provisions in the 2006-2010 revenue reset by ESCV on SP Ausnet.

The ECCSA has noted the trend of networks to increase the scope of pass through events in recent years. Equally, the ECCSA has also noted the continuing increases in insurance costs included in the opex allowed in regulated revenue reset allowances.

The ECCSA (and the MEU) recognise that the extent of pass through event allowances and the amount of insurance included in a revenue reset change the risk profile of regulated networks. The greater the ability to pass through costs to consumers (such as that recently allowed SP Ausnet electricity distribution) and the amount of insurance cover included in the opex allowance, the less the risk to the business and the greater the risk to consumers.

If the risk to a network business is reduced, then the equity beta used in the rate of return calculation is impacted and should also be reduced. It is simply not acceptable for a network business to transfer risks to consumers and expect to receive the same rate of return on their assets.

For example, the rate of return that was awarded SP Ausnet by the ESCV in 2005 reflected the assessed risk profile of the business. Subsequently, the Tribunal recently decided to reduce the risk faced by SP Ausnet resulting from actions it takes to mitigate the potential for bushfires to be initiated by powerlines. In this regard it should be noted that the class action against SP Ausnet is predicated on the assumption that SP Ausnet did not operate its network in accordance with "good industry practice" (on which the allowed opex was based) and therefore was responsible for the damage from the bushfires it allegedly caused. As a result of the potential for costs being awarded against it, SP Ausnet effectively sought relief from any such award by changing (ex post) the pass through provisions included in the ESCV regulatory decision. The AER initial decision on this matter was appealed to the Tribunal which allowed the appeal.

The fact that the Tribunal did not reflect that reducing the risk to SP Ausnet (by allowing the pass through) should be balanced by a lower rate of return to reflect the lower risks faced, is of concern to consumers and reflects the key outcome of the Limited Merits Review Panel reports concerning the poor performance of the Tribunal in consistently being oblivious to the requirements of the National Electricity and Gas Objectives.

In previous decisions, the AER had balanced the risk carried by the regulated network with the amount of risk transferred to consumers through the pass through provisions. Implicitly this means the equity beta allowed reflected the amount of risk exposure carried by the regulated firm.

It appears that ElectraNet is seeking in its application to reduce its risk exposure and increase the amount of risk which will be transferred to consumers via the extension of the pass through provisions. Acceptance of these proposals means that the risk profile of the firm is further reduced and this reduced risk should be reflected in the allowed equity beta.

ElectraNet also ties into the application, the extent of the insurance cover it is expected to carry as a competent network provider. As the cost of this insurance is included in the opex that is allowed, it is obvious that this cost is effectively paid for by consumers. If the risks that the insurance covers are reduced, then it would be expected that the cost of the insurance would be less. Having said this, the cost of insurance is also a function of the amount of insurance claims made by a firm. This means that the level and cost of insurance required is reflective of the historic performance of the firm – a firm that frequently claims on its insurance incurs higher premiums. To ensure that insurance costs are not excessive requires the firm to operate at levels which preclude the frequent access to insurance. There needs to be a careful assessment as to the level and premium of the insurance cover that reflects "good industry practice" (ie the level of insurance a competent network provider considers is appropriate and the extent a competent network provider accesses this insurance).

The ECCSA enumerates its concerns regarding the ElectraNet claim as follows:

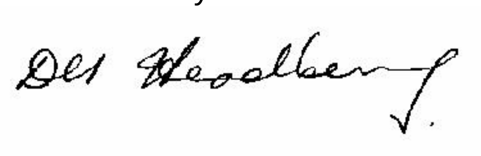
1. The level of insurance that a regulated firm requires, should be set on the basis that the firm will operate to “good industry practice” with the high likelihood that the insurance will not be called on. To a large extent, this is implicit in the amount of opex that the firm is permitted as the amount of line maintenance is critical to ensure “good industry practice” is applied. The risk to consumers is that less opex is used and this causes the need for an insurance claim. In this case, consumers would pay the costs above the cap and allow the network provider to retain the benefit of the opex under-run.
2. If the insurance cap is exceeded, there are two possible outcomes – firstly that this is a risk for the firm or secondly the cost is passed through to consumers. If the risk is accepted by the firm then it is entitled (as is the current approach) to have a higher rate of return to reflect the acceptance of this risk. If the cost is passed onto consumers, then a lower rate of return should be allowed to reflect the lower risk exposure.
3. As with the cap on insurance, if other (more) risks are to be passed through to consumers (such as by expanded definitions of terrorism or natural disaster events) then these should be balanced by a reduction in the rate of return.

The ECCSA is very concerned that network businesses in the NEM see themselves as an endangered species and therefore must be protected by consumers at consumers’ costs!

As the AER addresses the ElectraNet application and this additional proposal, the AER must ensure that there is an appropriate balance between the:

- Opex allowed,
- Amount included for insurance for the extent of its cover,
- Past performance of the service provider in terms of opex and insurance claims,
- Extent of the pass through provisions, and
- Rate of return allowed

Yours faithfully



Public Officer
Major Energy Users, Inc