24 May 2013

Mr Arek Gulbenkoglu
Director
Australian Energy Regulator
Level 37, 360 Elizabeth Street
Melbourne VIC 3000

By email: incentives@aer.gov.au

Dear Mr Gulbenkoglu

Response to the AER questions addressed to the Incentives workstream dated 10 May 2013

Thank you for the opportunity to respond to the questions listed in your paper titled *Transitional issues relating to the proposed opex incentive scheme*.

The Energy Networks Association (ENA) is the peak national body representing the businesses operating Australia's energy transmission and distribution networks. Member businesses provide energy to virtually every household and business in Australia.

The ENA responses to the Australian Energy Regulator (AER) questions are set out below. These responses are based only on our preliminary analysis and understanding of the model provided. Due to the complexity of the model workings, and transitional issues it encompasses, further consideration or understanding of future models may raise additional issues beyond the scope of this response.

Question 1. Do stakeholders agree that any transitional arrangements should aim to provide NSPs with the same marginal benefit if we set opex forecasts exogenously or by applying a base year approach?

The ENA does not support the use of operating expenditure (opex) forecasts being set "exogenously". As noted in previous submissions, the ENA considers that the revealed cost framework must remain as the default opex assessment method, paired with a base, step trend forecasting approach. If the AER considers that base year expenditure is inefficient and requires adjustment, then other techniques, such as benchmarking, should only be used as an indicator to guide where further analysis may be required.

Where the AER proposes to adjust the revealed costs of the Network Service Provider (NSP), then the distribution of efficiency gains and losses will be significantly altered under the existing Efficiency Benefit Sharing Scheme (EBSS). While it does not support exogenous opex forecasts, the ENA agrees that any transitional arrangements should aim to provide NSPs with the same marginal benefit irrespective of the basis on which opex forecasts are set.

Question 2. Do stakeholders agree with the transitional issues identified above?

The AER analysis indicates that if the opex forecast for the following regulatory period is not calculated with reference to the revealed costs of the NSP, then it may result in NSP obtaining a disproportionately large benefit (or penalty) from an underspend (or overspend) from:

- permanent changes in opex;
- changes to non-recurrent opex in year 4; and
- changes to non-recurrent opex in year 5.

At this stage, the ENA has not identified any other issues using the AER model.

Question 3. Are there other issues that stakeholders consider are material if an NSP is transitioned from the current opex forecasting approach and EBSS, to the new proposed exogenous forecasting approach and associated EBSS?

The AER identifies that its approach to calculating carryovers will need to be reviewed for NSPs that are likely to have their opex forecast for the following regulatory period based on an adjustment to the revealed cost approach. The ENA notes that it is imperative the arrangements ensure that any carry-over benefits of efficiencies delivered during the current regulatory period are maintained.

The ENA also notes that the AER appears to have included in its worksheets its variant of the EBSS to apply to NSPs that have their revealed costs adjusted in setting the opex forecast allowance. This “cumulative” model appears to provide a 30 per cent sharing ratio, however the modelling is not intuitive and seems to rely on cell B12 and a building block adjustment into perpetuity. To enable the NSPs to have a clear understanding of how the incentive scheme works and be able to respond to it, then the AER needs to provide a simpler model. A second best alternative is for the AER to hold a workshop specifically focused on these matters to explain its proposed model in more detail and ensure all stakeholders understand its full implications.

We look forward to discussing the issues raised in these responses with you in more detail at the next workshop. Please feel to call me to discuss any queries the AER has regarding the matters in this letter at any time on (02) 6272 1555.

Yours sincerely

G. Crawford

Garth Crawford

Principal Advisor, Economic Regulation