

# Energy Action Group

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Attention Mr Sebastian Roberts  
General Manager  
Transition Group  
Australian Energy Regulator

## **Submission to AER Regulatory Accounting Methodologies Position Paper**

Dear Sebastian

Please find attached the Energy Action Groups comments the AER  
Regulatory Methodologies Position Paper.

Yours Sincerely

John Dick  
President

**Energy Action Group  
Submission to  
AER Regulatory Accounting Methodologies Position Paper**

The Energy Action Group (EAG) is a not for profit incorporated association representing the interests of less-than 160 MWh consumers across the National Electricity Market. The organisation has participated in at least eight network revenue determinations across the NEM since 1996.

EAG believes that strong, robust and definitive regulatory accounting methodology is vital for effective network regulation. It is most unfortunate that the Accounting Methodologies Position Paper fails to address the clear and obvious regulatory accounting deficiencies and information disclosure problem across the NEM.

Further EAG was disappointed to see that the Position Paper fails to explicitly take into account the changing regulatory environment, particularly the significant MCE reform agenda to move towards a single national regulator for both transmission and distribution entities.

EAG strongly suggests that if consumers the ultimate beneficiaries of the reform program are to have any confidence in the regulatory decision making approach outlined in the Statement of Regulatory Principles (SRP), then there needs to be reliable, consistent data employed in any evaluation process carried out within a business, between businesses and various transmission projects and any possible alternatives to a specific project or projects.

***Issues of Concern from the Position Paper.***

- It is of major concern that the “as commissioned” approach is not consistent with the AER’s ex ante incentive regime established in the AER Statement of Regulatory Principles.
- The Position Paper fails to demonstrate why the “as commissioned” approach is administratively more complex.

***Significant issues not addressed by the Issues Paper***

Many of the questions raised in the Position Paper e.g. the overlapping relationship between opex and capex particularly as assets age, would be answered if the AER, the jurisdictional regulators and the umbrella organisation the Utility Regulators Forum developed and adopted a robust, enforceable set of regulatory accounting, resource allocation principles (not unenforceable regulatory guidelines). This will become even more critical, should merits review provision be extended (as currently proposed by network providers) to cover electricity and gas access reviews.

One of the major deficiencies in the Australian implementation of the building block approach to light handed incentive regulation is the huge information asymmetry between the business and the regulator agency. Consumers have even less access to

relevant network regulatory accounts information, making it almost impossible to assess the merits of a network revenue application or to comment coherently on network proposals and their alternatives.

Consumers are also concerned by significant changes in network investments that occur at regulatory resets without some forewarning and discussion does not inspire consumer confidence in the regulatory arrangement.

### ***Important Oversights in the Position Paper***

EAG notes that the current AEMC Chapter 6 review has the potential to raise questions about the Compendium of Electricity Transmission Guidelines and the SRP and that the AEMC might end up recommending some overall changes to the current AER regulatory approach to revenue determinations and project alternative evaluation outlined in the Compendium of Electricity Transmission Guidelines.

One of the major problems with the current information disclosure guidelines across the NEM is that they are only “guidelines”. It is imperative that the AER and the jurisdictional regulators develop a robust set of Regulatory Accounting principles and standards to be used for allocating costs across a business. The AER also needs greater powers to obtain information disclosure.

EAG recognises that the United States regulatory approaches, primarily based on using Cost of Capital/“Rate of Return” reporting requirements have very high cost and is extremely intrusive. However, given the long history of the US state based regulators and the strong overarching role of the National Association of Regulators Utility Commissioners, the US regulators have developed an effective, detailed comprehensive set of accounting requirements/standards.

**EAG strongly recommends that the AER considers and adopt the use of much tighter standards and definitions for gas and electricity regulatory accounting purposes.**

### ***A Solution***

The AER and the jurisdictional regulators should be developing a far more robust set of Regulatory Accounting Standards as a matter of some urgency so that they can facilitate comparable data sets over time to form the basis of regulatory decision making. The current regularly guidelines are so weak that they make it almost impossible to carry out an effective long term inter and intra business comparison. It is important for the market to be able to assess the efficacy of the building block approach to incentive regulation to see whether it delivers efficient long term benefits and outcomes that benefit consumers.

The jurisdictional regulators particularly NSW IPART and Victorian ESC highlight the deficiencies of weak (pathetic would be a better description) regulatory accounting guidelines. Both regulators have had to spend considerable resources and time to obtain meaningful comparable data to analyse for their recent electricity distribution pricing reviews. EAG understands that the ACCC electricity team would

have experienced similar difficulties as IPART and the ESC with the recent Transgrid/ Energy Australia regulatory determinations.

A robust set of regulatory accounting standards for the regulatory accounts also helps to ameliorate some of the information asymmetry between the businesses, regulators and end users and has the potential to reduce the potential of regulatory “gaming” by regulated businesses.

The EAG is aware, like most market observers and participants that the AER responsibilities are going to increase with the transfer of jurisdictional network regulatory responsibilities. This development adds to the urgency of the need for a far more robust set of Accounting Requirements/standards rather, than continue with the current weak guidelines.

One of the legacies of the weak regulatory guidelines is that recent ACCC TransGrid /Energy Australia revenue determination delivering significant different regulatory account information than will be provided in the forth coming AER Powerlink revenue determination. This deficiency makes it almost impossible effectively benchmark regulated entities and to compare any long term regulatory efficiencies under inventive regulation regime.

EAG prays that the regulatory accounting requirements will develop greater robustness and consistency before the ElectraNet, SPI PowerNet and TransEnd determinations begin. The level of importance increases of a robust effective accounting reporting regime increases even further after the transfer of responsibilities of distribution regulation flows through from the jurisdictions.

There is a second major problem after meaningful reliable data collection, the lack of any powers of disclosure. **There appear to be no processes in place to give the AER (or any of the jurisdictional regulators) an effective legal basis to get the regulated entities to disclose appropriate or relevant material for regulatory purposes.** The recent Victoria ESC United Energy and related parties transactions Judgement by the Victorian Electricity Tribunal further highlights the problem for regulators.

### ***Regulatory Certainty***

Consumer like regulated network service providers also need regulatory certainty. It is not only the regulated entities that require a stable investment and regulatory environment; consumers also need to see and believe that the regulatory approach under building block incentive regulation gives long term outcomes that provide benefits to all market participants, particularly non market participants the consumers who underwrite the revenue stream of the network service providers.

Regulatory accounting in any form will impose some additional costs on the reporting entity and the question is how onerous will the costs be. The decision by the AER on the nature of the reporting regime must have an underlying objective for the regulatory accounts that they are timely, transparent and have internally consistent information that can be provided to the market. Regulatory accounting cost are more

of a secondary consideration in the decision making process on the accounting methodology.

Most consumers' participating in the NEM regulatory and decision making process have difficulties with the quality of the regulatory accounts, the timeliness of the reports, the transparency and internal consistency of information provided in the public domain<sup>1</sup>. **This issue must be addressed by the AER if consumers and the market are to have confidence in regulatory proceedings.**

### *Comments on the Position Paper*

The current interpretations of the regulatory guidelines have facilitated the two different approaches of adding capex to the RAB; "as incurred" reflects an accrual accounting year by year approach, while the "as commissioned" approach reflects the full contribution of an investment/project to a business when it enters productive service.

The "as commissioned" approach to adding the capital invested in a project to the RAB after the commissioning of the project reflects the tried accounting practice of bringing an asset into service and depreciating it once it is commissioned. If the project takes more than 12 months and costs more than \$20 m then provision should be made to capitalise interest that would have been incurred during the construction phase of the project at the WACC rate.

There are problems with both the "as incurred" and "as commissioned" approaches to managing investment and adding project capex to the RAB.

It is important to note that both approaches fail to address problems relating to construction project cost over-runs adding dollars onto the real RAB. The Transgrid MetroLink project provides a useful example where in the end, under the current incentive based regulatory regime, the inclusion or exclusion of capex (and interest to be capitalised) would be determined by "regulatory judgement" (note the earlier cautionary comment on merits review).

One of the questions that the AER does need to address in the finalised version of position paper and its accounting policy development process is how does the regulatory environment provide certainty to the network service provider and at the same time protect consumers from funding poorly executed projects!

The current regulatory accounting guidelines ensure that the numbers used to formulate a regulatory determination and used to exercise regulatory judgement are pretty rubbery. This approach clearly fails to deliver consistent reproducible results for both the network service providers and consumers. The other significant down side of weak accounting guidelines and inconsistent regulatory determinations based on inconsistent numbers is that it increases the potential for an appeal against the regulatory revenue determination.

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<sup>1</sup> EAG along with other consumer advocates believe that there should be complete disclosure of information by regulated monopoly businesses. The current regulatory arrangements on information disclosure could be likened to extracting teeth with out an anaesthetic.

This dilemma has been highlighted in part by the Transgrid MetroLink project. The project had a massive cost over-run, due to environmental and planning factors combined with construction delays. The problem for TransGrid and more importantly the ACCC (now AER) was how to derive the best outcome ensuring regulatory certainty for the network service provider. MetroLink highlights the problem of regulatory certainty for regulated network service providers. EAG understands that PowerLink is proposing some \$ 2 B worth of capex under the next 5 year regulatory reset.

Both NSW and Qld have recently shown dramatic blow-outs in distribution network construction programs over the last regulatory period and projected through into the current regulatory period. The regulatory accounting and reporting regime should have the capacity to forewarn the regulator and consumers that network business capex programs have blown out or that the investment circumstances, raw materials/labour costs, have changed to cause a capex blow out.

It is EAG's contention that network service providers reporting under a robust set of regulatory accounting standards on an annual basis would highlight the problem of construction cost over-runs earlier than it has become obvious to most parties participating in regulatory pricing determinations under the existing regulatory reporting regime.

It is worth noting that this project/submission was refused funding by the NEM Advocacy Panel as they doubted that EAG had the competence to get involved in this important issue. If this submission had been funded by the Advocacy Panel then EAG would have devoted substantially more resources than we have to this submission.

### **Conclusion/Recommendation**

**The AER needs to devote more time to establishing robust regulatory accounting principles and if the outcome is at odds with the Statement of Regulatory principles then change the Statement of Regulatory Principles.**

**The AER requires greater information disclosure powers.**