



Ref.: CP/TM-L

14 May 2008

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Dear Mr Pattas

## **Roll Forward Model for Electricity Distribution Network Service Providers**

Ergon Energy Corporation Limited (Ergon Energy) appreciates the opportunity provided by the Australian Energy Regulator (AER) to comment on the development of the Roll Forward Model (RFM) to support the transition to a nationally consistent framework for the economic regulation of electricity distribution networks.

The attached submission represents Ergon Energy response to the AER's proposed RFM Handbook and the accompanying Explanatory Statement.

Ergon Energy would welcome the opportunity to discuss this submission or provide further detail regarding the issues that it has raised should the AER require.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Tony Pfeiffer', with a stylized flourish extending to the right.

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# **Ergon Energy Corporation Limited**

**Proposed Electricity Distribution Network  
Service Providers Roll Forward Model**

**– Submission**

**Australian Energy Regulator**

**14 May 2008**

# Proposed Electricity Distribution Network Service Providers Roll Forward Model – Submission

**Australian Energy Regulator**

**14 May 2008**

This submission, which is available for publication, is made by:

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# TABLE OF CONTENTS

<b>Overview .....</b>	<b>3</b>
<b>1 Introduction .....</b>	<b>3</b>
<b>2 Rule Requirements .....</b>	<b>3</b>
<b>3 Reasons for the roll forward model .....</b>	<b>3</b>
<b>4 Issues raised in submissions and the AER response.....</b>	<b>3</b>
4.1 Consistency with RFM for transmission .....	3
4.2 Adjustments for final year of previous period .....	5
4.3 Inflation .....	5
4.4 Linkages with information requirements .....	5
<b>5 AER preliminary positions .....</b>	<b>5</b>
5.1 Input sheet (Section 2.1) .....	5
5.2 Actual RAB roll forward sheet (Section 2.3) .....	7
5.3 Tax value roll forward sheet (Section 2.5) .....	7

## Overview

Ergon Energy Corporation Limited (Ergon Energy) welcomes the opportunity to provide comment to the Australian Energy Regulator (AER) on its consultation “*Proposed electricity distribution network service providers roll forward model*” (April 2008) (Explanatory Statement) and proposed “*Roll forward model handbook*” (April 2008) (RFM Handbook). This submission is provided by Ergon Energy, in its capacity as an electricity distribution network service provider (DNSP) in Queensland.

Ergon Energy is available to discuss this submission or provide further detail regarding the issues that it has raised should the AER require.

### 1 Introduction

No comment.

### 2 Rule Requirements

No comment.

### 3 Reasons for the roll forward model

No comment.

### 4 Issues raised in submissions and the AER response

#### 4.1 Consistency with RFM for transmission

*The explanatory statement indicates that DNSPs will be able to suggest the use of forecast depreciation as it may be required under transitional provisions or otherwise suit the particular characteristics of the business.*

Ergon Energy understands forecast depreciation to mean the depreciation allowance for the current regulatory control period as approved by the relevant jurisdictional regulator.

Ergon Energy seeks confirmation of this interpretation of forecast depreciation.

To the extent that this interpretation is correct, Ergon Energy understand, that depreciation in the RFM may take the form of straight-line depreciation as calculated by the RFM (incorporating actual capital expenditure during the current regulatory control period) or forecast depreciation for the period as determined by the jurisdictional regulator.

Ergon Energy seeks confirmation that these are the only two available options for calculating depreciation in the RFM. Further, Ergon Energy seeks confirmation that the use of actual depreciation incurred by a DNSP (as reported in regulatory reporting statements) is strictly prohibited in the RFM.

In terms of practical application, it is unclear whether DNSPs can directly enter forecast depreciation amounts for each year into the RFM, thereby overriding the RFM's depreciation calculation for those years. Ergon Energy seeks clarification that this is the case and, if so, suggests that a note to this effect be included in the RFM or the RFM Handbook.

Consistent with the principle of financial capital maintenance, Ergon Energy understands that the use of forecast depreciation means that any above-forecast capital expenditure in the current regulatory control period will be rolled into the RAB at its undepreciated value at the start of the next regulatory control period.

Ergon Energy seeks formal confirmation that this is the case.

In the event this is not the case, Ergon Energy seeks clarification from the AER as to how above-forecast capital expenditure in the current regulatory control period will be included in the opening RAB for the next regulatory control period.

*The explanatory statement indicates that the RFM and PTRM require assets to be grouped according to common lives.*

*The AER also questions whether the proposed 50 asset categories are necessary for most DNSPs such that the generic models would require amendment.*

Ergon Energy acknowledges that grouping assets according to common (standard) lives is possible to implement and simplifies the process of calculating straight line depreciation in a practical sense. However, it does not result in a sensible grouping of assets and represents a significant deviation from current regulatory arrangements agreed with the jurisdictional regulator. At the 23 April 2008 Forum, Ergon Energy understood that the AER would accept the functional grouping of assets as per the current regulatory arrangements.

Ergon Energy seeks confirmation as to whether assets are required to be grouped according to common standard lives or if assets can be grouped as per the current regulatory arrangements. Grouping assets according to function is Ergon Energy's preference.

Ergon Energy agrees that 50 asset categories would exceed the requirements of most (if not all) DNSPs and cannot see the benefit in amending generic models to incorporate such a change.

However, Ergon Energy notes that there should be sufficient flexibility in the generic models to accommodate the differing requirements of individual DNSPs. At the 23 April 2008 Forum, Ergon Energy understood that the AER would develop an RFM and PTRM template with 30 asset categories. Ergon Energy supports the use of 30 asset categories and seeks confirmation that this is the AER's intention.

Ergon Energy is unclear of the relationship between the asset categories used by a DNSP in the RFM and those used by a DNSP in the PTRM. Ergon Energy understood that the actual asset categories are required to be the same between the RFM and the PTRM.

Ergon Energy seeks confirmation that this is the case or, to the extent that it is not, Ergon Energy seeks clarification of the relationship between the asset categories in the RFM and those in the PTRM.

## 4.2 Adjustments for final year of previous period

*The RFM requires DNSPs to include information relating to the final year of the previous regulatory control period in order to facilitate adjustment to the RAB as per clause S6.2.1 of the National Electricity Rules (Rules).*

Ergon Energy notes that no such adjustment is required to Ergon Energy's RAB as the RAB value is specified in the table in clause S6.2.1 of the Rules (we note that there has been a further amendment to this amount and it is now \$4,232.4M). Ergon Energy notes that the jurisdictional regulator (the Queensland Competition Authority) previously adjusted the opening RAB during the current regulatory control period to reflect differences between forecast and actual values in the previous regulatory control period. That adjusted RAB is reflected in the table in clause S6.2.1 of the Rules. Accordingly, there is no rationale for Ergon Energy to include information in the RFM relating to the final year of the previous regulatory control period.

Ergon Energy seeks formal confirmation in the RFM or the RFM Handbook that information relating to the final year of the previous regulatory control period is not required in cases where the RAB reported in clause S6.2.1 of the Rules has been previously adjusted by the jurisdictional regulator.

## 4.3 Inflation

The AER's conclusion in the Explanatory Statement does not appear to address Ergon Energy's question raised in its previous submission (as noted in the Stakeholder comments), which was:

*Ergon Energy seeks clarification regarding the AER's intending interpretation of inflation and indexation, including whether actual inflation can be interpreted to mean inflation as it relates to the use of actual capital expenditure and actual depreciation in roll-forward calculations.*

Further clarification is sought from the AER on this matter.

## 4.4 Linkages with information requirements

Ergon Energy supports the AER's intention to undertake a separate consultation process with businesses regarding the development of information requirements.

# 5 AER preliminary positions

Ergon Energy provides the following comments regarding on the proposed RFM Handbook.

## 5.1 Input sheet (Section 2.1)

Mention should be made that forecast nominal capital expenditure may need to be provided for the final **two** years of the current regulatory period, as actual data for those years will potentially not be available at the time of submission of a regulatory proposal.



For consistency with the input sheet of the RFM, an additional bullet point should be added to the existing five bullet points as follows:

- *actual nominal customer contributions - as-incurred*

In addition, the sentence preceding the bullet points should be amended to: "This sheet has been split into six sections".

### ***Opening regulated asset base***

The RFM Handbook should clarify the requirement for an opening RAB in the case where a DNSP proposes more than one form of price control (e.g. where it is proposed that standard control services be divided into those subject to a revenue cap form of price control, while others are subject to a weighted average price cap form of price control). Ergon Energy understands that an opening RAB must be provided for the assets used to provide services under each of the proposed forms of price control.

### ***Asset class name***

Ergon Energy suggests that the RFM Handbook should provide:

- Clarity on what asset class groupings are acceptable to the AER; and
- Guidance for DNSPs transitioning into the new regulatory regime by indicating that existing asset classes used by jurisdictional regulators are acceptable asset categories to use in the RFM (i.e. grouped according to function).

### ***Opening asset value***

As per the comments provided in the RFM spreadsheet, the RFM Handbook should indicate that the opening asset values are to be "Based on the opening RAB values in the final year of the previous regulatory control period".

### ***Remaining life and standard life***

The RFM Handbook indicates that the remaining life will be based on the economic life of the assets as at the start of the current regulatory control period and that these values (and standard lives) should be consistent with those used in the previous determination.

Ergon Energy notes that the remaining and standard life of assets may differ from those used in the previous determination. In particular, asset lives may differ due to the use of different asset classes in the RFM compared to those used in the previous determination.

Ergon Energy requests that the RFM Handbook acknowledge that there may be legitimate reasons for differences in asset lives between the RFM and the previous determination.

### ***Actual nominal capital expenditure and Actual nominal asset disposals***

The RFM Handbook notes that the reported actual capex and actual asset disposal values are assumed to be in mid-year terms.



At present these figures are reported in Ergon Energy's Regulatory Reporting Statements in end-of-year terms, not mid-year terms.

At the 23 April 2008 Forum, Ergon Energy understood that capex and asset disposals actuals and forecasts information could be entered "as-is" (i.e. in end-of-year terms as currently collected) into the RFM, with no mid-year adjustments.

Ergon Energy seeks formal confirmation that this is the case.

## **5.2 Actual RAB roll forward sheet (Section 2.3)**

To improve clarity, Ergon Energy suggests the following modification to the third sentence in the second paragraph:

*The RFM handles such variances by adjusting the closing RAB to reflect the actual capex and actual regulatory depreciation for each year.*

## **5.3 Tax value roll forward sheet (Section 2.5)**

To improve clarity, Ergon Energy suggests the following modification to Box 6: "Rolling forward the tax asset values":

***Opening tax asset value for the final year of the previous regulatory control period***

*+ Nominal actual net capex for the final year of the previous regulatory control period*

*- Nominal actual tax depreciation for the final year of the previous regulatory control period*

***= Closing tax asset value for the final year of the previous regulatory control period***

***= Opening tax asset value for year 1 of the current regulatory control period***

*+ Nominal actual net capex for year 1*

*- Nominal actual tax depreciation for year 1*

***= Closing tax asset value for year 1 of the current regulatory control period***

***= Opening tax asset value for year 2 of the current regulatory control period***

...

**= Closing tax asset value for year 5 of the current regulatory control period**

**= Opening tax asset value for the next regulatory control period**