



Final decision

**Electricity transmission network service providers
Submission guidelines**

September 2007

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Shortened forms

AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
ETNOF	Electricity Transmission Network Owners Forum
MEU	Major Energy Users Inc.
NEM	National Electricity Market
NER	National Electricity Rules
TNSP	transmission network service provider

1. Introduction

The Australian Energy Regulator (AER) is responsible for regulating the revenues of transmission network service providers (TNSPs) in the National Electricity Market (NEM) in accordance with the National Electricity Rules (NER).

The submission guidelines set out the requirements on a TNSP when developing and submitting a revenue proposal for the AER's consideration.

The first proposed submission guidelines and associated issues paper were released in January 2007 for public consultation. In developing this final decision, consideration was given to the objectives of the National Electricity Law (NEL) and NER and the submissions received.

The AER received seven submissions from VENCORP, the Electricity Transmission Network Owners Forum (ETNOF), the Major Energy Users Inc.(MEU), Alinta, Energex, the APA Group and EnergyAustralia. The submissions have been addressed in this final decision and any changes identified as necessary have been made to the guidelines and the relevant appendixes. This document has been prepared to satisfy the AER's obligations under clause 6A.20(e) of the NER.

2. Rule requirements

Clause 11.6.17 (f) of the NER requires the AER to publish the guidelines by 30 September 2007. Under clause 6A.10 the guidelines must:

- specify the form of a revenue proposal and negotiating framework
- include a requirement for TNSPs to submit any revenue proposal to the AER in accordance with the guidelines
- include a requirement for any information contained in or accompanying a revenue proposal to be audited or otherwise verified.

Clause 6A.20 of the NER details the process that the AER must follow in developing, amending or reviewing the guidelines.

3. Purpose and objectives of the guidelines

The guidelines set out the information that a TNSP must provide in the revenue proposal and proposed negotiating framework it submits to the AER. The objectives of the guidelines are to:

- contribute to the NEM objective
- be consistent with the principles in the NER
- promote transparency in the information provided by a TNSP and the decisions made by the AER
- assist in the setting of efficient capital and operating expenditure allowances in transmission determinations.

4. The reasons for the guidelines

The guidelines are based on the AER's previous information requirements guidelines, but modified in light of the amendments to chapter 6 of the NER, resulting in the new chapter 6A.

The guidelines primarily formalise the existing practices for the submission of a revenue proposal. The guidelines:

- detail a series of principles relevant to a TNSP's preparation of historic and forecast information for its revenue proposal and proposed negotiating framework
- detail the required contents of a TNSP's revenue proposal for its prescribed transmission services and the timing and basis for submitting this proposal to the AER
- detail the required contents of a TNSP's proposed negotiating framework that sets out the procedure to be followed in negotiations between the TNSP and a service applicant who wishes to receive negotiated transmission services from the TNSP
- contain a series of pro forma statements that a TNSP must use when providing the information required in its revenue proposal to the AER. These pro forma statements relate to historic and forecast operating and capital expenditure; the weighted average cost of capital; depreciation and the parameters for the service target performance incentive and efficiency benefit sharing schemes.

The guidelines promote the NEM objective by detailing the required basis for a TNSP to prepare and submit to the AER its revenue proposal and proposed pricing methodology regarding its prescribed transmission services and negotiating framework for its transmission services. The guidelines require the TNSP to provide in these documents the minimum information requirements specified in the NER and additional information requirements specified by the AER. The AER will assess the information provided when making its transmission determination.

5. Issues raised in submissions and the AER's response

Interested parties raised five main issues, stating that the guidelines:

- lack clarity regarding the necessity and form of audits
- require inappropriate historic capital expenditure information
- lack clarity regarding the cost reporting templates
- should establish safe harbour provisions
- require inappropriate need for directors' sign off.

Appendix A contains a discussion and the AER's response to other issues raised in submissions, which can be found at the AER's website: www.aer.gov.au.

5.1 Audits of supplied information

Submissions received from ETNOF, VENCORP and EnergyAustralia expressed concern regarding the first proposed guidelines' requirement for an audit of supplied information. The submissions highlighted three main areas of concern namely, clarity of audit requirements, audits of forecast expenditure information and audits subject to a duty of care to the AER.

Regarding the issue of clarity, VENCORP stated that the audit obligations included in the first proposed guidelines had the potential to impose a significant regulatory burden on TNSPs without necessarily achieving a corresponding benefit. They also stated that the guidelines should specify the type of information that must be audited and that it may not be feasible for the TNSP to consult with the AER on the choice of the auditor before the relevant regulatory accounting date. VENCORP does not consider that the AER should be able to require a further audit or appoint its own auditor to be employed by the TNSP and that the guidelines should clarify whether historical information is required to be audited.

EnergyAustralia stated that because the revenue proposal is a forward-looking document it would be impossible to get an auditor to provide an audit opinion on matters up to seven years in the future. It was further noted that the AER would use its own consultants to verify the reasonableness of the assumptions underlying any forecast expenditure proposal and that an audit of such assumptions by the TNSP would not confer any real benefit.

The submissions also stated concerns about an auditor appointed by a TNSP owing a duty of care to the AER. It was considered that this would not be appropriate.

ETNOF raised similar points in their submission stating that:

... the audit on expenditure forecasts would be limited to assessing the process that was adopted by the TNSP when deriving its forecasts and whether the TNSP has correctly described how the assumptions made have been translated into the forecasts. Accordingly,

the AER would still need to rely upon technical advisers for assessing the veracity of the assumptions and (where relevant) forecasting methodologies the TNSPs adopted.

AER response

The AER notes the concerns about the level of uncertainty provided by the first proposed guidelines regarding audit requirements. The AER seeks to achieve a balance between too little clarity and being too prescriptive in the guidelines, thereby reducing the available flexibility to deal with individual TNSP circumstances. The AER will add additional information in the audit requirements to provide the extra clarity sought by the regulated businesses.

The AER notes that the proposed audit requirements for forecast expenditure information should not apply as this may place an additional burden on the regulated businesses that is not justified by the benefits gained. This is particularly the case given that an expenditure proposal is assessed by the AER and its consultants to check on the reasonableness of assumptions underlying the proposal.

The AER also agrees that the requirement for an auditor, engaged by a regulated business, to provide an explicit duty of care to the AER is unnecessary. An auditor used by a TNSP will owe a duty of care to anyone relying on the auditor's information, including the AER, and who would suffer loss if the auditor was negligent.

AER decision

To give effect to the above response, the AER has made the following amendments to the guidelines:

- delete section 2.8(b) and replace with:

The AER requires that an audit of the historic capex and opex information is performed before, and be provided to the AER to accompany, the submission of a TNSP's revenue proposal.

- delete section 2.8(c) and replace with:

The audit of historic capex and opex information must be a regulatory audit report as outlined in these guidelines (see examples set out at appendix C) and must cover at a minimum the following matters:

- (1) *basis and application of cost allocation methodology;*
- (2) *arithmetic accuracy; and*
- (3) *reconciliation to financial statements.*

- delete section 2.8(h).

5.2 Submission of detailed information regarding historic capital expenditure

ETNOF submitted that the requirements of the first proposed guidelines for TNSPs to provide substantial information on historic capital expenditure is excessive under the new ex ante regime.

ETNOF stated that it was concerned that the fundamentally different analysis required by the ex ante regime compared to the ex post regime has not been reflected in the guidelines or accompanying material. ETNOF also states that the guidelines propose the continued provision of very detailed information about past capital expenditure even though it is of little consequence to the revenue review.

Specifically, ETNOF stated that they could not foresee how information on specific past capital expenditure projects could be justified in this regard except for those TNSPs that are yet to be subject to an ex post review, in which case it should be a transitional matter and the guidelines should recognise it as such.

The MEU stated that the AER had identified the bulk of the information that should be included as part of a TNSP's revenue proposal. It considered, however, that the proposed requirements for historic capital and operational expenditure were insufficient. The MEU also stated that the AER should require more historic information from TNSPs—ten years of actual capex and opex outcomes with the forecast amounts originally allowed.

AER response

The AER considers that the provision of information on historic capital expenditure is a necessary component of the revenue proposal process, but this is not related to an ex post assessment of that expenditure. The historic capital expenditure, while not subject to the same level of review under an ex-ante regime as under an ex-post regime, is still required by the AER for the following reasons:

- The AER and its consultants are able to use the information to analyse the relationship between cost drivers and their effect on project costs. Examining the actual and estimated costs of a representative range of completed projects can assist in our understanding of how costs may change in the future.
- The project-specific templates also allow the AER to select individual regulatory test assessments for appraisal.
- The information is used to ensure arithmetic accuracy to verify the opening regulatory asset base (RAB); to provide an understanding of past expenditure trends (e.g. replacement, large projects); and to ensure that past expenditure is not included in forecast expenditure.
- Historic information on asset classes is needed for depreciation calculation for the asset base roll-forward model.
- This information is needed for transitional purposes in the case of TSNPs that have not yet had a revenue reset.

- The information presents as a general test of the TNSP's forecasting ability.
- This information is necessary to fulfil an obligation the AER has under the NER to assess historic costs against the original forecasts when determining if the AER is satisfied with the new forecasts provided by the TNSP.

The guidelines do not require a TNSP to provide justification for expenditure. For example, the guidelines do not seek information on the reasons why a project was undertaken. As such, the guidelines do not require the same level of information as the capex prudence assessment under the draft regulatory principles.

Regarding the MEU's point about providing ten years of historic information, the AER must consider several matters:

- The quantum of information the AER actually requires to carry out its regulatory functions, that is, the amount of historic cost information the AER will require as an input to the assessment of a TNSP's forecast expenditure. The AER's long-standing approach has been to require five years of historic cost information, being information which relates to the current regulatory control period.
- A five-year period covering the current regulatory control period aligns with the inputs required for the AER's asset base roll-forward model (which calculates the opening RAB for the next regulatory period) and the efficiency benefits sharing scheme (important to the AER's incentive-based regulatory regime under which TNSPs retain the benefit/loss of incremental efficiency changes for five years after the year in which the incremental change was made).
- Schedules 6A.1.1 and 1.2 of the NER also require that a revenue proposal must contain information on capital and operating expenditure relating to the current regulatory control period.
- A major objective of the AER is to create a streamlined, efficient and cost-effective regulatory environment.
- Finally, interested stakeholders are able to access information relating to the AER's previous revenue cap decisions and annual TNSP regulatory reports, all of which are available on its website.

AER decision

The AER has decided to retain the requirement for regulated businesses to provide information on their historic capital expenditure in the format and time span set out in the first proposed guidelines.

5.3 Clarification of cost-reporting template requirements

Submissions received from ETNOF, VENCORP and EnergyAustralia all sought further clarification on sections of the proposed cost-reporting templates included in the first proposed guidelines. Specific sections where clarification was sought includes the distinction between mandatory and discretionary headings, the nature of the definition

sections included in the cost-reporting templates and the requirements for additional material relating to historic capital expenditure.

AER response

The AER considers that additional clarification in the above areas is broadly appropriate. Ensuring a balance between being prescriptive where necessary and flexible where possible is a key goal in the development of the cost-reporting templates.

Specifically, the AER considers that for mandatory and discretionary headings, all headings contained within each individual cost template should to some extent be discretionary. Regulated businesses will be able to discuss with the AER, before lodging a revenue proposal, the categories and headings that best fit their business model. This will be done in such a way that any burden on the business when completing the cost-reporting templates is minimised, while still satisfying the AER's need for a complete picture of the proposed and historic expenditure of the regulated business.

This flexibility should also extend to the definition sections of the cost-reporting templates so that a regulated business is not forced to adapt its information to fit into a rigid definition of an asset class or expenditure category. Instead, the definitions should be adapted to explain the headings, asset classes and categories used by the regulated business in completing the cost-reporting templates.

Finally, the AER notes that under the ex-ante framework the request for additional material regarding the prudence of historic expenditure is no longer required when analysing the proposed expenditure for a regulated business.

AER decision

The AER has made the following amendments to the guidelines to reflect the above position:

- Additional clarification for the use of discretionary headings within each cost-reporting template.
- Instructions noting that the definition sections of the templates should be developed by the TNSP.
- Removal of the requirement for additional information in the historic expenditure-reporting templates.

5.4 Safe harbour provisions

ETNOF stated that it would be inappropriate for the AER to narrowly prescribe what it will and will not accept as elements of a revenue proposal where the NER contemplates that TNSPs would make a proposal. Instead, ETNOF made a submission that 'safe harbour' provisions would be an appropriate form of prescriptive guidance in the guidelines.

AER response

The AER agrees that ‘safe harbour’ provisions can be useful when applied to legislation that carries financial penalties, for instance, however, the AER does not consider that the use of such provisions in the guidelines is appropriate. The AER notes that there was little detail provided on how safe harbours would be implemented into the guidelines framework.

The AER has examined the practices of other energy regulators, at jurisdictional level in Australia and also internationally, and has not found instances where ‘safe harbour’ provisions were used in a way proposed in the submission. The AER considers that the guidelines allow substantial latitude for regulated businesses to develop a revenue proposal in a flexible manner. Therefore, the application of ‘safe harbours’ in the context of the guidelines seems to add little value for TNSPs. Further, any revenue proposal accepted by the AER will serve as an example to other regulated businesses of what the AER is likely to accept.

AER decision

The AER has decided not introduce the use of ‘safe harbour’ provisions into the guidelines.

5.5 Director’s responsibility statement

ETNOF’s submission stated that the proposed director’s responsibility statement imposed additional obligations beyond those required by the NER. ETNOF stated that the requirement for directors to verify that ‘all information provided in support of this revenue proposal is, in the opinion of the directors, a reasonable representation of the historic and forecast capital and operation expenditure’ was an inappropriate requirement to be included in the director’s responsibility statement.

AER response

The AER has reviewed the requirement and agrees that the above requirement should be removed from the guidelines. The AER notes that the director’s responsibility statement should provide an appropriate level of assurance consistent with the TNSP’s obligations under the NER.

AER decision

The AER has deleted the above requirement from the director’s responsibility statement and replaced it with the following:

The directors of [the TNSP] hereby certify that:

.....

.....

- *Capital and operating expenditure forecasts are based on the best available information at the time of submission; and*

- *The historic capital and operating expenditure information provided in support of this revenue proposal is drawn up to present fairly in accordance with the AER's submission guidelines and cost allocation guidelines.*

Appendix A: Other issues

Submissions were received from:

- VENCorp
- Electricity Transmission Network Owners Forum (ETNOF)
- Major Energy Users Inc.(MEU)
- Alinta
- Energex,
- APA Group
- EnergyAustralia.

(Please note: submissions containing all issues can be found on the AER’s website: www.aer.gov.au)

ISSUE	PARTY	RESPONSE
<i>1. High-level issues</i>		
1.1 The guidelines do not distinguish clearly where the AER intends to create new obligations rather than add explanation to an NER requirement.	ETNOF	The AER notes that the guidelines are consistent with the provisions of the National Electricity Rules and, as such, no distinction is necessary.

<p>1.2 Uncertainty as to which headings in the templates are intended to be ‘mandatory’ and which are intended to be ‘discretionary’</p> <p>Directions and detailed definitions in the templates should be transferred to the guidelines.</p>	ETNOF	<p>Please refer to the final decision paper.</p> <p>Definitions are more accessible in the templates themselves, due to linking between worksheets. This is important when the completed worksheets are placed on the web. Users can check definitions without having to read the entire guideline.</p> <p>Further, there is room in the templates for TNSPs to provide their own definitions, which would not be possible if they were placed in the guidelines.</p>
<p><i>2. Information requirements</i></p>		
<p>2.1 Verification of forecasts impossible; can only provide a reasonable forecast. Verification requires proof of accuracy.</p>	ETNOF	Please refer to the final decision paper.
<p><i>3. Audit obligations</i></p>		
<p>3.1 Audit obligations have the potential to impose a significant regulatory burden on TNSPs without necessarily achieving a corresponding benefit. The AER should specify in the guidelines the type of information that must be audited. It may not be feasible for the TNSP to consult with the AER on the choice of the auditor before the relevant regulatory accounting date. Otherwise, the guidelines should specify the minimum requirements for selection of the auditor.</p>	ETNOF, Alinta	Please refer to final decision paper.
<p>3.2 A duty of care should not be to the AER or is unnecessary.</p>	ETNOF, Alinta	Please refer to final decision paper.

<i>4. Information on historic capex</i>		
4.1 The information requirements relating to historic capex are considered to be excessive and should only relate to information the AER genuinely needs.	ETNOF, Alinta	Please refer to final decision paper.
4.2 The AER should require more historic information from TNSPs—ten years of actual capex and opex outcomes with the forecast amounts originally allowed.	MEU	Please refer to the final decision paper.
<i>5. Clarity of obligations</i>		
5.1 Safe harbour provisions should be included in the guidelines.	ETNOF	Please refer to decision paper.
<i>6. Publication</i>		
6.1 The AER should specify a list of information that would be deemed non-confidential and that all other material could be claimed as confidential subject to application by the TNSP.	ETNOF	The guidelines follow the requirements of the NER.

Appendix B: Submission guidelines