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Warwick Anderson
General Manager – Networks Finance and Reporting Branch
Australian Energy Regulator
GPO Box 3131
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Dear Mr Anderson

Response to proposed amendments to the Distribution Roll Forward Model

I refer to the AER's explanatory statement on the proposed amendment to the distribution roll forward model (version 2), 31 August 2016. Jemena Electricity Networks (Vic) Ltd (**JEN**) welcomes this opportunity to make a submission on the proposed amendment to the distribution roll forward model (**RFM**).

JEN has consulted with Energy Networks Association (**ENA**) during our review of the proposed changes to the RFM. JEN supports the views put forward within the ENA paper regarding inflation.

Our submission is set out in **Attachment 1**. It focuses on other impacts of the proposed changes.

If you have questions in relation to the submission, please contact me on (03) 9173 8231 or at Matthew.serpell@jemena.com.au .

Yours sincerely

Matthew Serpell
Manager Asset Regulation & Strategy

Attachment 1

1. OUR SUBMISSION

This document is Jemena Electricity Networks (Vic) Ltd (**JEN**) response to the AER's request for feedback regarding their proposed changes to Version 1 of the Distribution Roll Forward Model.

1.1 ENA PAPER COVERING INFLATION ISSUES

The ENA paper emphasises that the Post Tax Revenue Model (**PTRM**) and the RFM must operate together in a consistent and supportive manner regarding the treatment of inflation. This provides a reasonable opportunity for service providers to recover benchmark approved returns on capital consistent with the NEL revenue and pricing principles.

Current market conditions create the primary issue to be addressed. The forecast inflation rates used to determine revenues are materially different from the actual inflation rates used to adjust prices under CPI-X adjustment process.

2. RESPONSE TO THE PROPOSED CHANGES TO DISTRIBUTION ROLL FORWARD MODEL

2.1 FORECAST OR ACTUAL DEPRECIATION

What was the proposed change?

As the AER now applies the CESS to JEN, the AER is proposing that a 'forecast depreciation' approach—where the real forecast depreciation amount (based on forecast capex) approved at the last reset for the DNSP—be used to roll forward the RAB.

What is the impact of the proposed change?

By replacing actual depreciation with forecast depreciation the AER aims to remove a duplication of incentives available to JEN for achieving efficient capital expenditure.

Jemena's opinion or recommendation

JEN agrees with this proposed change.

The amendments to the RFM support the objectives within the CESS guideline published by the AER in November 2013. The guideline flagged that the incentive scheme would work best when forecast depreciation is applied rather than actual depreciation.

2.2 REMAINING ASSET LIVES

What was the proposed change?

The proposed RFM now includes a calculation for remaining asset lives for Regulatory Asset Base (**RAB**) and Tax Asset Base (**TAB**) purposes in two new worksheets, RAB remaining lives and TAB remaining lives. These two worksheets are set up to accommodate the historical capex data needed to track the remaining asset lives year-by-year.

The proposed DNSP RFM uses the AERs standard approach to calculate remaining asset life, known as weighted average remaining lives (WARL).

What is the impact of the proposed change?

The WARL method, applied to both RAB and TAB calculations, links to the new output worksheet titled "PTRM input summary". Despite making the asset remaining life calculation more transparent, the proposed change results in a specific depreciation method being linked to, and applied within, the

PTRM which retains the repeated grouping of assets at successive price reviews. The implication is that other depreciation methods, which may be more suitable, have not been allowed for.

Jemena’s opinion or recommendation

JEN does not agree with this proposed change for a number of reasons.

JEN supports the full implementation of the year-on-year tracking to calculate depreciation. To fully implement a year-on-year tracking approach the AER would also need to:

- Insert additional calculations within the two new RFM worksheets which show the depreciation waterfall implied within the calculated closing balances;
- Remove reference to remaining lives within the new “PTRM input summary” as they would not be required; and
- Modify the opening balance depreciation line for each asset type within the PTRM to allow a direct reference back to the depreciation values within the RFM (see point 1 above).

Additionally JEN believes the EDPR process is the proper channel to select and implement the remaining asset life calculation. For example, in the recent Final Determination for JEN, the AER accepted JEN’s year-on-year approach to depreciation and moved away from their position regarding WARL.

2.3 END OF PERIOD ADJUSTMENTS

What was the proposed change?

The proposed RFM includes a new input section in the ’RFM input’ worksheet where end of period adjustments are made. This allows additions to, or deductions from, specific asset classes at the end of a regulatory control period. The example provided by the AER related to the ad-hoc reclassification of assets from standard control services to alternative control services.

What is the impact of the proposed change?

The proposed change allows for transparent adjustments to be made to both the RAB and TAB asset bases which flow through the model as adjustments to the opening balances after accounting for remaining life assumptions.

Jemena’s opinion or recommendation

JEN agrees with this proposed change for two reasons.

The new inputs avoid the need for future ad-hoc modifications to the template, decreasing the risk of modelling errors.

The inputs increase the transparency of specific adjustments by isolating the RAB and TAB impacts and defining the impact on return of capital (regulatory depreciation) via the remaining life inputs.

2.4 ANNUAL WACC UPDATES

What was the proposed change?

The proposed RFM has been modified so that it can accommodate different annual WACC inputs over the regulatory control period within the ’RFM input’ worksheet.

What is the impact of the proposed change?

The change primarily relates to the way the inputs are entered rather than impacting on the structure of calculation.

Jemena's opinion or recommendation

JEN agrees with this proposed change.

The proposed change is consistent with the changes to the PTRM and gives effect to the AER's rate of return guideline, which allows for an annual update for the return on debt.

2.5 OTHER MINOR CHANGES

What was the proposed change?

Some other minor changes were proposed by the AER which were largely cosmetic.

What is the impact of the proposed change?

Although some new worksheets were added, the other minor proposed changes have minimal impact on the RAB RFM calculations.

Jemena's opinion or recommendation

JEN agrees with these proposed changes.

2.6 OTHER OBSERVATIONS

While reviewing the proposed RFM some minor issues were identified which are worth clarifying with the AER.

1. How would an ex-post review adjustment be accommodated in this model?
    a) There is no mechanism to amend the yearly profile of actual capex. By implication the model requires net capex after accounting for ex-post review adjustments which does not transparently account for historical changes to the RAB.
2. Should the dollar basis in F225 of "RFM input" be Real 2015 rather than nominal to avoid the need for a half year adjustment relating to the timing of capital expenditure?
3. Is the AER intending to address or mark up the following changes?
    a) Within the TAB remaining lives worksheet, the standard tax life rows from column N onwards contain hard coded values (45 years) instead of formulas
    b) RAB roll forward, K438 to R467
    c) RAB roll forward, K664 to R693