

The Changing Regulatory Environment

Implications for the Electric Net Draft Decision

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The Regulatory Environment has Changed

- Productivity Commission has for some time expressed reservations with the way in which regulation is being applied (e.g. the National Access Regime Review)
- Government is to make specific changes to TPA (Part IIIA) which clearly "endorse the thrust" of the PC's recommendations.
- The WA Supreme Court's Epic Decision provides an interpretation of the National Gas Code which is consistent with the Government's proposed changes to Part IIIA

Government

- Change TPA Part IIIA to guide implementing regulators
- Insert objects clause
 - "The objective of this part is to promote the economically efficient operation and use of, and investment in, essential infrastructure services, thereby promoting effective competition in.. "
- Insert pricing principles
 - Set prices to generate revenues that are "at least sufficient to meet the efficient costs of providing access"
 - "include a return on investment commensurate with the regulatory and commercial risks involved"
- Allow form erits review of ACCC decisions by the ACT

W A Supreme Court's Epic Decision

- Provides guidance on how to apply objects clauses
- Defined what the economic terms in the National Gas Code mean:
 - References to competition mean "workable" or "effective" competition – not perfect competition
 - References to efficient mean that which would be found in "workably" competitive markets
- Similar terms are in the National Electricity Code
- This decision is not necessarily binding upon regulators in other jurisdictions or under other regulatory instruments, but other Courts are likely to find it persuasive

Implications

- **There is no one right answer!**

- Regulators should be less ambitious and err on the side of investment in the presence of uncertainty

- **It is inappropriate to set revenues that are:**

- Based on a perfect competition benchmark
- Just sufficient to ensure continued operation

- **The specific circumstances of the business need to be taken into account**

- Includes regulatory and commercial risks (not just CAPM risk)
- possibly including past investment costs

- **Regulators should avoid forensic reviews of businesses' proposals – merely ensure that they are not inconsistent with workable competition (ie. regulate by exception)**

ElectraNet Draft Decision

- **Applies the “just sufficient” revenue paradigm**
 - “the Commission’s regulatory regime attempts to ensure that the return on capital allowance in the revenue cap is equivalent, and only equivalent, to the risk adjusted market rate of return required to maintain investment”
- **Applies the “perfect market” hypothesis**
 - Assumes that the benefits of accelerated depreciation are passed to customers immediately when estimating the effective tax rate
- **Ignores ElectraNet’s particular circumstances**
 - In setting capex and opex benchmarks
- **Does not carry forward innovative elements of the current EPO**

What the ACCC should do now

■ Rewrite its Draft Statement of Regulatory Principles

- so that they are consistent with 'workable' rather than 'perfect' competition benchmarks
- so that they encourage investment in necessary essential infrastructure

■ Review all of its Draft Decisions

- to ensure that they are consistent with the Government's and the Court's interpretation of the regulatory instruments