



AER Rule Change Proposal

Promoting efficient investment in the
interest of consumers

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Overview

- Principles and objectives of the National energy laws
- Current framework
- AER's proposed rule changes
 - Expenditure
 - Weighted Average Cost of Capital
 - Process efficiency

National Electricity objectives

“ to promote efficient investment in and efficient operation of electrical services in the long term interests of consumers with respect to price, quality, safety, reliability and security of supply. ”

Revenue and pricing principles

- networks ‘should be provided with a reasonable opportunity to recover at least the efficient costs the operator incurs’ in providing services and complying with regulatory obligations
- networks ‘should be provided with effective incentives in order to promote economic efficiency’ including efficient investment in and provision and use of network services
- regard should be had to the economic costs and risks of the potential for under and over investment by a regulated network service provider

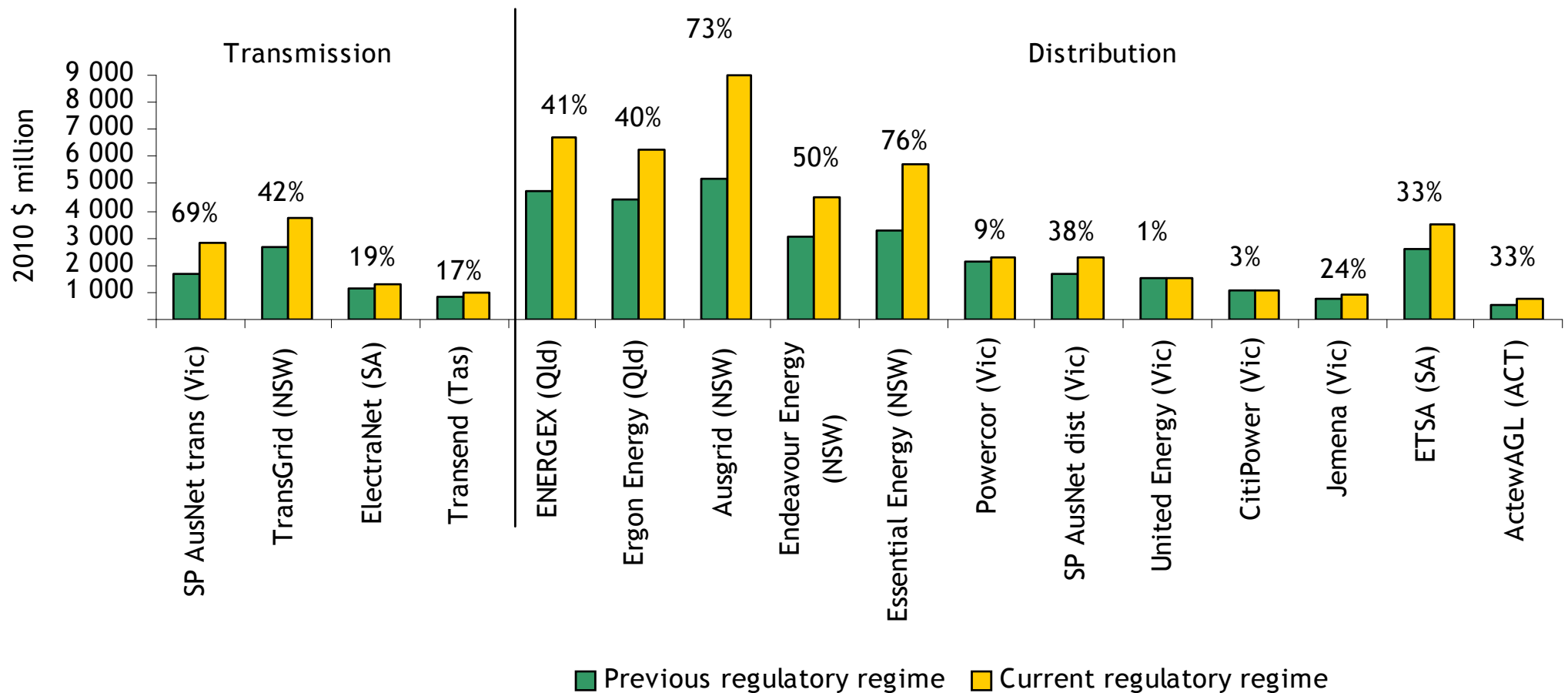
The 2006 amendments

- Concerns about adequacy of infrastructure investment
- Approach adopted significant departure from other industries and both internationally and in state based regulatory regimes
- Focused on certainty of environment for investment—hard-wiring regulatory practice

Step change in revenues

- An entire round of network determinations for all NSPs in the NEM will be completed in April 2012.

Approved electricity transmission and distribution revenues previous and current periods



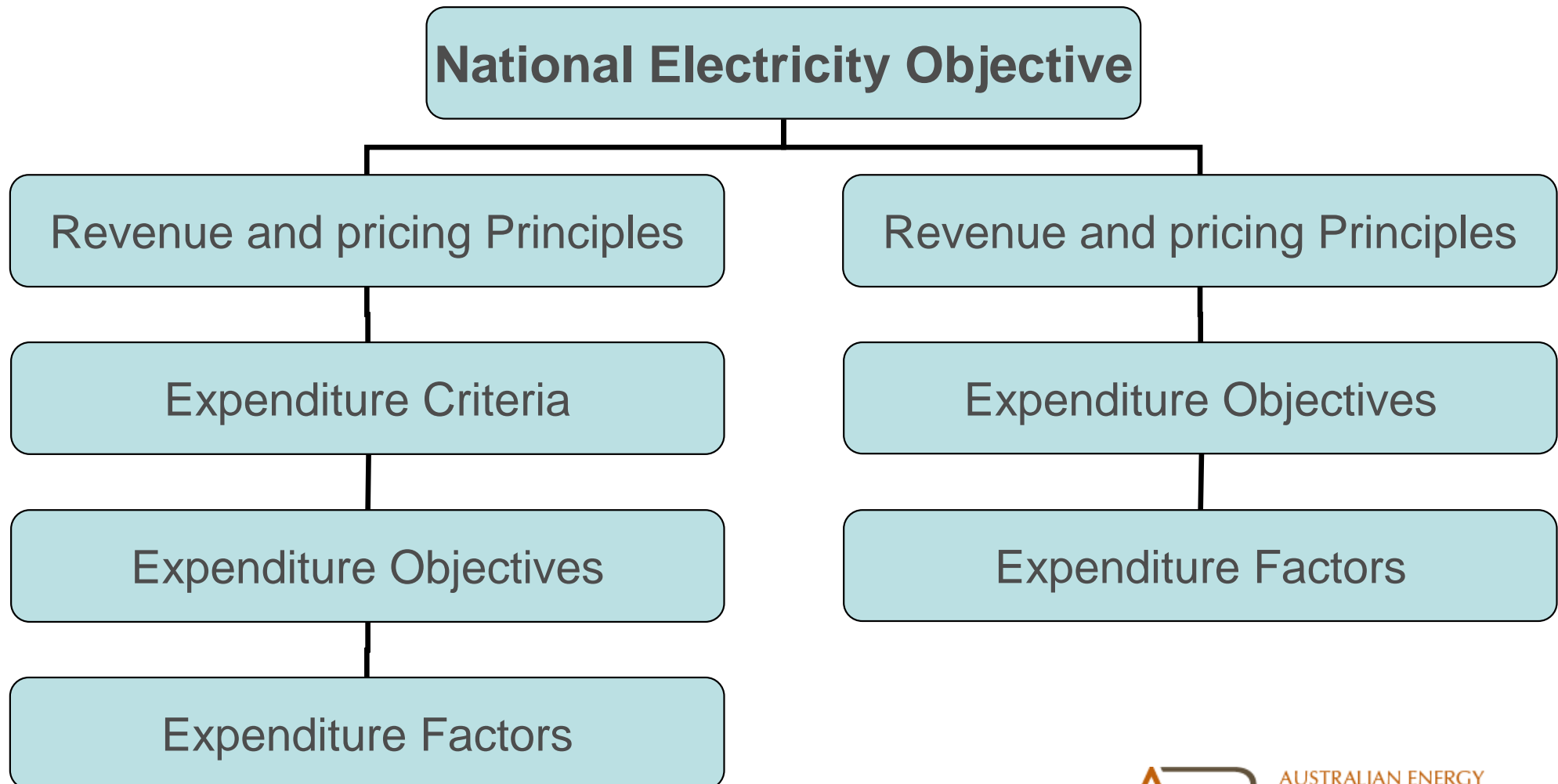
Overview of proposals

- The AER's rule change involves three key areas:
 - the capex and opex framework, including removing some of the restrictions on assessment and response to proposals
 - incentive arrangements, including changes to provide stronger incentives to spend no more than is necessary and efficient, while providing a robust framework to deal with uncertainty
 - the cost of capital, including establishing a new streamlined framework for setting the cost of capital parameters and providing greater certainty.
- The rule change proposal also includes amendments to improve the efficiency of the regulatory determination process.

Snapshot of the framework

CURRENT

PROPOSED



Expenditure - current

- ‘Reasonably reflects’ test
- Network business proposes forecast and leaves the evidentiary burden on the AER to prove that the proposed forecast is not efficient and not prudent
- This problem is further compounded for distribution due to two further restrictions on forming a substitute:
 - minimum extent necessary
 - based on the original proposal

Example evidence

| | |
|---------------|-------------------------------|
| Victorian DBs | reinforcement capex |
| TransGrid | assessment of sample projects |

Setting forecasts – AER proposal

- Process begins with a revenue proposal
- Expenditure objectives unchanged
- AER to assess information submitted using a range of different techniques
- Bounded by the requirements in the Law and guided by a clear, consistent and transparent list of expenditure factors

Strengthen the incentives

- Only capex up to the forecast would be automatically added to the RAB
- Any expenditure in excess of the forecast would be subject to a 40/60 sharing factor
- Greatly strengthens the discipline on the networks to focus on efficient expenditure

Managing uncertainty

- Purpose built provisions to deal with uncertainty and unforeseen events:
 - locked-in materiality threshold
 - contingent projects for distribution networks
 - re-opener provision for distribution networks
- Ensures a reasonable opportunity to recover at least the efficient costs

Cost of capital

- 3 regimes currently apply across gas and electricity distribution and transmission
- Propose one WACC review
- Remove the definition of the DRP benchmark—to be determined in WACC review
- Balances keeping pace with the developments in the financing practices, while still providing the certainty for investors

Process efficiency

- Ensuring that stakeholders have the opportunity to consider and comment on information put forward by networks
- All relevant information to be included in original or revised proposals
- Allow AER to determine weight to be applied to confidential information in network proposals – as currently applies to confidential information in stakeholders' submissions

Wrap-up

- Balanced package-
 - Promoting efficient investment and long term interest of consumers
- Consistent with revenue and pricing principles
- Enhanced incentives for efficient investment