PowerWater

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Dr Patrick Walsh
Utilities Commissioner
Utilities Commission
GPO Box 915
Darwin NT 0801

Dear Pat

Re: 2014-2019 Networks Price Determination: Framework and Approach Consultation Paper – Supplementary Submission

Thank you for the opportunity to make a supplementary submission on the Utilities Commission's (the Commission) Framework and Approach Consultation Paper for the 2014 Networks Price Determination.

Circumstances have changed since Power and Water Corporation (Power and Water) made its earlier submission on the Commission's Framework and Approach Paper (dated 17 August 2012), and Power and Water considers that a price cap form of price control represents a significant risk to the networks business in the current environment. Power and Water requests that the Commission reconsider its proposed position in relation to the form of price control, for the reasons outlined below.

Power and Water also addresses in this submission a request made by the Commission to outline in more detail the work involved in transitioning from a pre-tax to a post-tax approach and revenue model.

Form of price control

In the response to the Commission's Framework and Approach Consultation Paper submitted on 17 August 2012, Power and Water indicated support for the Commission's proposal to continue with a weighted average price cap (WAPC) form of price control for the 2014 Networks Price Determination.

Power and Water notes that the formal consultation process for the discussion of the Networks Price Determination framework has now ended. However, circumstances have recently changed, with the new NT Government bringing with it a sharper focus on economic rationalisation.

This has prompted Power and Water to carefully review the implications of the form of price control. Power and Water is concerned that the risks to revenue inherent in the WAPC may compromise Power Networks' ability to provide the service our customers require. Power and Water considers that a WAPC represents a significant risk to the networks business, and that the adoption of a revenue cap would be more appropriate in the current environment.

Under a WAPC, Power Networks is exposed to sales volume variations. Any variation between forecast sales volumes and actual sales over the five year regulatory control period is reflected in the revenue that the network business receives. This represents a significant risk to the network business in a period of uncertain economic growth and sales outcomes. This uncertainty is currently being experienced in Australia. Issues such as customer response to increasing prices and the impact of demand initiatives, photovoltaics (PV) and carbon pricing have resulted in the recent occurrence of decreasing electricity consumption.

In view of the very substantial risk to network revenue arising from differences between the forecast sales volume and actual sales, Power and Water proposes a revenue cap to eliminate this business risk for Power Networks.

The increased revenue certainty from reduced volume risk that a revenue cap would provide in the current environment is important to maintain the on-going commercial viability of the Power Networks business.

The proposed use of the WAPC is also out of step with the Australian Energy Regulator's (AER) most recent considerations.

The AER's Preliminary Framework and Approach paper for NSW signals an important change in regulatory thinking and a departure from its previous approach[1,2]. The AER proposes to alter the form of price control for the NSW distributors from a WAPC to a revenue cap and considers there would be a net benefit in so doing.

The principal reason that the AER has advanced for proposing this change is that it considers that a WAPC provides a lower likelihood of a DNSP recovering its efficient costs. With a WAPC, revenue varies with the volume of sales, whereas the majority of a DNSP's costs are fixed and correlated to peak demand.

Having regard to these matters, Power and Water requests the Commission to reconsider its proposed position.

In the event that the Commission decides to retain the WAPC, Power and Water considers that the risk-adjusted rate of return for the network must be increased, to compensate for the additional revenue risk that would be imposed on Power Networks.

Post-tax approach

In the response to the Commission's Framework and Approach Consultation Paper submitted on 17 August 2012, Power and Water also indicated its preference to adopt a pre-tax approach for the 2014 Network Price Determination, and to transition to the AER's post-tax approach for the 2019 Network Price Determination for the fifth regulatory control period.

The Commission has requested further information from Power and Water as to the work involved in transitioning from a pre-tax to a post-tax approach and revenue model.

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[1] AER, Discussion Paper - Matters relevant to the framework and approach, ACT and NSW DNSPs 2014–2019 - Control mechanisms for standard control electricity distribution services in the ACT and NSW, April 2012.

[2] AER, Preliminary positions - Framework and approach paper - Ausgrid, Endeavour Energy and Essential Energy - Regulatory control period commencing 1 July 2014, June 2012.

Power and Water's tax is calculated at a consolidated level. In order to comply with the post tax model, 5 years of tax returns will need to be analysed to separate out the components of timing and permanent differences that relate to Power Networks. In some cases the information may need to be built up as the data is not already held within Power and Water's systems. Power Networks is not a separate legal entity, merely a business unit, therefore it does not hold a typical balance sheet showing all working capital as the Corporate business unit acts as central Treasury and the Retail business unit holds debtors. In order to calculate tax payable correctly a full balance sheet needs to be developed as if Power Networks is a separate legal entity. Power and Water Corporation is moving toward doing this for all its business units but this has not occurred and is a large body of work.

The resource requirement to gather this data will be significant and can only be done by staff that are tax specialists, due to the complexity of tax. Using consultants is not an option as information would need to be provided to them, and it is the data gathering that is the onerous part of this exercise that will need to be undertaken by Power and Water staff.

Power and Water requests that the Commission focus on areas of a higher priority for the 2014 Networks Price Determination, and Power and Water will commit to undertake the transition to a post-tax approach for the 2019 Networks Price Determination.

In the event that the Commission decides to maintain its preliminary position to adopt a post-tax approach and revenue model for the 2014 Networks Price Determination, Power and Water will require guidance from the Commission on issues such as the treatment of timing differences and tax losses.

Please contact Mr Antoni Murphy, Acting Manager Regulation, Pricing and Economic Analysis, on (08) 8985 7124 should you have any questions or require further information.

Yours sincerely

Andrew Macrides
Managing Director
31 October 2012