

30/05/2018

Mr Warwick Anderson
General Manager
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Lodged via email: aerinquiry@aer.gov.au

Dear Mr Anderson

Draft position paper – Profitability measures for electricity and gas network businesses

TransGrid welcomes the opportunity to provide comments on the Australian Energy Regulator's (AER) draft position paper on profitability measures for electricity and gas network businesses.

TransGrid is the operator and manager of the high voltage transmission network connecting electricity generators, distributors and major end users in New South Wales and the Australian Capital Territory. TransGrid's network is also interconnected to Queensland and Victoria, and is instrumental to an electricity system that allows for interstate energy trading.

TransGrid recognises the interest shown by consumer groups and the AER in the profitability of regulated network businesses. However, it is important to ensure that the measures used and the data underlying those measures are fit for purpose, and will provide the basis for meaningful comparisons. We have significant concerns that this may not be achieved. We have contributed to an industry response through Energy Networks Australia. We would also like to highlight some broader concerns with the approach for this project to ensure that the process is robust and any outputs are meaningful.

TransGrid's concerns relate to the following issues, which are explained further below:

1. Interaction of profitability measures with incentive-based regulation.
2. Provision of commercial information beyond the regulated business.
3. Limited basis for allocating some costs.
4. Increasing complexity, duplication and confusion in relation to financial information.
5. Limited ability to make meaningful comparisons across businesses.
6. Cost of data provision.
7. Availability of historic data.

1. Interaction of profitability measures with incentive-based regulation

Incentive-based regulation is founded on the premise that consumers will be better off in the long term if businesses have an incentive to out-perform. Incentive to out-perform is provided by allowing them to keep the gains of out-performance in the short run. In the medium term these gains are shared with customers.

Any analysis of profitability should not undermine the incentive to out-perform regulatory targets, which is a foundation of the framework applied by the AER.

2. Provision of commercial information beyond the regulated business

The AER's role relates to the regulation of prescribed services, and any data collection and publication should be mindful not to extend beyond legitimate interest in the regulated part of the

business. Comprehensive information on TransGrid's regulated activities is provided annually to the AER through regulatory information notices (RIN).

TransGrid is concerned that the AER's proposed profitability measures will require more detailed data provision relating to the non-regulated parts of TransGrid's business. We consider the data being requested represents regulatory over-reach by extending beyond the legitimate interests of the regulator of TransGrid's prescribed services.

3. Limited basis for allocating some costs

Using measures which require actual tax and interest payments to be extracted (for example, net profit after tax) are problematic because TransGrid's tax and financing arrangements are undertaken for the business as a whole, not separately for the prescribed and non-prescribed parts of the business. It is not clear how these costs would be meaningfully allocated between the different parts of the business.

4. Increasing complexity, duplication and confusion in relation to financial information

As a privately owned business TransGrid is required to finance its activities via a combination of equity and debt raisings in the financial markets. TransGrid is concerned that publishing an additional layer of financial information – some of which could duplicate information in the RIN, and some of which diverges from both regulatory information and standard statutory information - will be complex and confusing. As a result it is likely to be vulnerable to misinterpretation, particularly in the markets where we are seeking to raise finance.

5. Limited ability to make meaningful comparisons across businesses

There are a number of issues involved in attempting to provide statutory data that allows a meaningful basis for comparison with other electricity network businesses and across businesses in other parts of the economy. This includes:

- > Differing accounting policies, for example in relation to asset valuation. TransGrid's statutory accounts use 'fair value', while other businesses may use historic cost, which also has a flow-through impact on depreciation expense.
- > Differences in the treatment of provisions and intangibles including goodwill.
- > Differences in capital structure with associated impacts on finance costs and equity return.

TransGrid considers that regulatory information should be the focus of analysis for the purposes of regulating the business, since it forms part of the foundation of the regulatory framework. Furthermore, using a mixture of regulatory and statutory information has the effect of introducing a lack of comparability between measures due to their fundamentally different basis.

6. Cost of data provision

There will be significant costs involved in the process proposed by the AER. There are two aspects to this cost:

- a. Developing consistent information standards so that meaningful comparisons can be made. At the AER forum stakeholders proposed establishing a technical working group to address this issue. We note that this process is likely to require an extensive period of time given the issues that needed to be addressed.
- b. Generating and auditing the proposed measures. Regulated networks already produce statutory accounts and regulatory information. The measures proposed by the AER would effectively require a third set of accounts to be generated by businesses, ie, 'adjusted' statutory accounts to be used in calculating profitability measures. Furthermore, the AER has indicated they would expect this data to be audited. Generating this audited information on an ongoing basis would require significant additional work which is not currently undertaken by the business.

7. Availability of historic data

TransGrid was privatised in December 2015. Accordingly, the first available full year of statutory accounts under current ownership is for the financial year ending 30 June 2017. The statutory accounts preceding privatisation had a significantly different capital structure under NSW State

Government ownership, and should not be used as a direct comparison to the accounts for the current TransGrid entity.

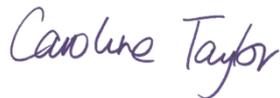
In conclusion, TransGrid recognises the interest of consumers and regulatory bodies in the profitability of regulated businesses. However, we have significant concerns about the measures proposed by the AER, in particular measures:

- > That require data which is not currently publicly available.
- > Which relate to the non-regulated parts of the business.
- > Which are not currently allocated between different parts of the business.

We are also concerned that producing additional financial information - which differs from both the statutory and regulatory accounts – has the potential to increase confusion and misinterpretation by financial markets and other stakeholders.

If you would like to discuss this submission, please contact Rachel Houston, Regulatory Consultant, on 02 9284 3336.

Yours faithfully



Caroline Taylor
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