

2. Prepayment Adjustment

2.1 Introduction

Section 9.2.5 of the Final Decision requires Envestra to reduce its Total Revenue by approximately \$1.8 million per year on account of a perceived financial benefit received by Envestra due to invoicing for its services monthly in advance.

The Final Decision is in error in requiring Envestra to make such an adjustment. This is because Envestra receives no ongoing pecuniary benefit through invoicing for its services in advance. That is, the fundamental premise upon which the Final Decision is made is incorrect and, rather than correcting for a gain received by Envestra, the Final Decision in fact imposes a loss upon Envestra.

Given that the Commission's Final Decision is in error, Envestra has made no such adjustment to its Total Revenue.

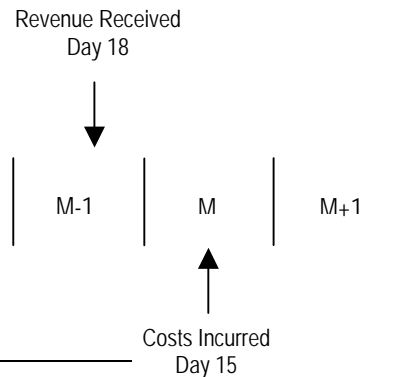
2.2 Envestra Position

In calculating the negative working capital adjustment from prepayment, the Commission has determined that Envestra will incur costs in the middle of the month that services are provided. It has then:

- adopted the existing cash flows for Envestra based on current invoicing terms i.e. revenue for the month in question is received on the 18th of the month prior to the month in which the service is provided; and
- compared the cashflows for Envestra with the cash flows of a notional entity, that it claims is similar to “a number of other energy distributors”¹. The notional entity is assumed to receive revenue on the 18th day after the month in which the service is provided.

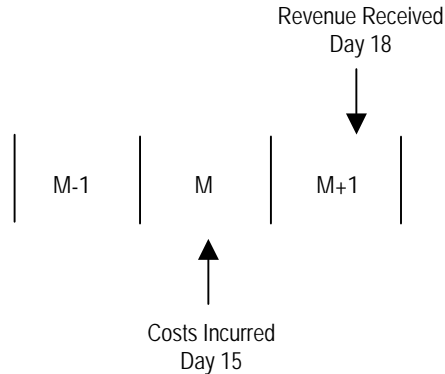
The timing of cash flows for Envestra and ESCOSA's notional entity is depicted in the diagram below where M denotes the month haulage services are provided.

Envestra



¹ Page 120 of the Final Decision. The Commission claims that this position is consistent with “generally accepted industry practice” and cites examples to support this claim. However, its claim that Envestra is treated more generously than Victorian distributors is an error of fact. Envestra’s Access Arrangement in Victoria provides for two invoices to be issued per month.

ESCOSA's Notional Entity



The Commission concludes that as Envestra receives revenue in respect of a specific month 60 days in advance of the notional entity Envestra is receiving a benefit and it is necessary to reduce Envestra's Total Revenue by approximately \$1.8 million per year to account for this benefit.

2.3 No Pecuniary Benefit

The fact that Envestra receives no ongoing pecuniary benefit from the receipt of the prepayment is demonstrated by the following example.

Suppose as from 1 January 1997 2 firms are established, Firm A and Firm B, providing distribution haulage services.

Firm A issues invoices in advance in the same manner as does Envestra. Firm B issues invoices monthly in arrears. Assume that in each month the charges due are \$100.

Firm A receives its first payment on the 18th of January 1997, being an amount of \$200 (the prepayment for January and February). Then on 18th February 1997 it receives another payment of \$100 (being the payment for March). On 18th March 1997, it receives another payment of \$100 (prepayment for April).

By the end of 1997 it has received an amount of \$1300 (as set out in the following table).

In contrast Firm B receives its first payment on 18 February 1997, being \$100 on account of services provided in January. Its next payment is received on 18 March 1997 being \$100 on account of February. By the end of 1997 Firm B has received \$1100.

Therefore during the first year of operation, Firm A has received \$200 more than Firm B.

The following table shows the payments received by the 2 firms in 1997:

Month	Firm A	Firm B
18 January 1997	\$200	\$0
18 February 1997	\$100	\$100
18 March 1997	\$100	\$100
18 April 1997	\$100	\$100

18 May 1997	\$100	\$100
18 June 1997	\$100	\$100
18 July 1997	\$100	\$100
18 August 1997	\$100	\$100
18 September 1997	\$100	\$100
18 October 1997	\$100	\$100
18 November 1997	\$100	\$100
18 December 1997	\$100	\$100
Totals	\$1300	\$1100

However in 1998, the cash flow of the 2 firms will be the same. On 18 January 1998, Firm A receives \$100 on account of the prepayment for February 1998. Firm B also receives \$100 on that date, on account of payment for services provided in December 1997. The payment streams for 1998 are shown in the following table:

Month	Firm A	Firm B
18 January 1998	\$100	\$100
18 February 1998	\$100	\$100
18 March 1998	\$100	\$100
18 April 1998	\$100	\$100
18 May 1998	\$100	\$100
18 June 1998	\$100	\$100
18 July 1998	\$100	\$100
18 August 1998	\$100	\$100
18 September 1998	\$100	\$100
18 October 1998	\$100	\$100
18 November 1998	\$100	\$100
18 December 1998	\$100	\$100
Totals	\$1100	\$1100

These payment streams will be the same for 1998, 1999, 2000, 2001, 2002, 2003, 2004, 2005 and 2006. That is, there is no ongoing financial benefit to Firm A from invoicing in advance.

Then move forward to 2007, and suppose that Firm A's total revenue is to be reduced (by amount "X") to compensate for perceived benefits received by Firm A due to invoicing in advance. Therefore in 2007 Firm A receives \$1100-X and Firm B receives \$1100. Firm A is disadvantaged as compared to Firm B on account of events which occurred 10 years previously.

Firm A represents Envestra (and Firm B the Commission's notional entity). The effect of the Commission's decision is to purport to penalise Envestra for an additional cash flow (as compared to Firm B) received 10 years previously, the benefit of which additional cash flow is long since exhausted (and would have been exhausted long before 2003 when Envestra's current Access Arrangement came into force).

Further, as the original haulage agreement with Boral Energy providing for the payment of invoices in advance was put in place at the time of Envestra's creation and float, whatever benefit Envestra received in 1997 from the prepayment would have been reflected in the price for Envestra's float and therefore paid for by Envestra's initial shareholders in the price they paid to purchase shares in that float.

Envestra notes that one of the original purposes of the prepayment was to provide Envestra with working capital to assist during the initial months of its establishment. This working capital could have been provided by other means. For example the prepayment could have been classified as a registration fee or as a deferred payment for gas transported in the months prior to Envestra's creation but which gas had not been metered and billed. Both such alternatives provide the same cash flow as that indicated for Firm A above, but neither such alternative would justify a decrement to Total Revenue in 2006 and neither alternative would have any impact upon the level of forward looking efficient costs from 2006. Given that invoicing in advance has the same cash flow impact as both these alternatives, it also should not have any impact upon the quantum of Total Revenue in the period from 2006.

As there is no ongoing benefit received by Envestra due to invoicing in advance, there is no "benefit" to be deducted from Total Revenue. As the premise on which the Final Decision is made is in error, the Final Decision itself is in error.

The effect of the Commission's decrement to Total Revenue is to deny Envestra the ability to earn a stream of revenue that recovers the efficient costs of delivering the Reference Service over the expected life of the assets used in delivering that service. This would violate the objective set out in section 8.1(a) of the Code.

Envestra also refers to the analysis in the report prepared for Envestra by NERA Economic Consulting "Envestra's Payment Terms in SA" which report expands upon the above argument and other matters relevant to the Commission's determination² and which report is incorporated into these submissions ("**NERA Report**").

If, for some reason, it were shown that Envestra did receive a benefit from the prepayment terms (the receipt of any such benefit being denied) then the period which should be used to account for that benefit is 27 days not 60 days. 27 days represents the period from the time Envestra receives a payment (the 18th of month_{n-1}) to the time when the Commission has determined Envestra begins incurring the costs of providing the services to which that payment relates (the 15th of month_n). The 60 days used by the Commission reflects the comparison between the time Envestra receives a payment and the time a payment would be received by a notional entity invoicing in arrears. But Envestra is not such a notional entity and therefore to compare it to such notional entity is an error.

2.4 Section 2.46 and 2.24

The Commission's decision takes no account of sections 2.46(b) nor section 2.24(a) of the Code. Neither of these sections are considered by the Commission in making its decision.

Section 2.46 provides that in assessing proposed revisions to an Access Arrangement, the Relevant Regulator must take into account the provisions of the Access Arrangement. In Envestra's submission, the effect of section 2.46(b) is that the Relevant Regulator should not unilaterally impose a change in the Access Arrangement, unless there has been a variation in circumstances requiring such a change. There is no such variation justifying the application of a decrement to Envestra's Total Revenue.

² Including the practices of other regulators in respect of setting of Total Revenue.

There is no discussion in the Final Decision of Envestra's legitimate business interests (section 2.24(a)) and why the application of a decrement to Total Revenue is appropriate despite those interests.

The absence of consideration of these issues further suggests that the application of a decrement to Total Revenue is not an appropriate exercise of the Commission's discretion.

2.5 Conclusion

The Commission's proposal to require a decrement to Envestra's Total Revenue because Envestra invoices in advance is inconsistent with section 8.1 of the Code in that it denies Envestra the ability to earn a stream of revenue that recovers the efficient costs of delivering the Reference Service over the expected life of the assets used in delivering that service. The proposal is beyond the Commission's power because the assumption underpinning the proposal is factually incorrect. The change required by Section 9.2.5 of the Final Decision has therefore not been made by Envestra to its Access Arrangement.