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Mr. John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
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via email: aemc@aemc.gov.au
Project Number ERC0134/ERC0135/GRC0011

Dear Mr. Pierce

**Consultation Paper on Savings and Transitional Arrangements
Draft National Electricity Amendment (Economic Regulation of Network Service
Providers) Rule 2012**

Introduction

The NSW Distribution Network Service Providers, Ausgrid, Endeavour Energy and Essential Energy, (the NSW DNSPs) appreciate the opportunity to make this joint submission in response to the Commission's proposed transitional arrangements for the implementation of the proposed National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012.

I would like to acknowledge the constructive dialogue that has occurred with staff from both the AEMC and the AER in considering alternatives to the initial AEMC transitional approach that would allow one determination under one set of Rules and result in an orderly transition to the new Rules in a manner that is acceptable to all stakeholders.

The NSW DNSPs note and endorse the letter to the Commission from the Energy Networks Association (ENA) dated 2 October 2012 regarding this Rule making process. Whilst the Commission has not clarified the status of its proposed transitional approach within the overall Rule making process, the NSW DNSPs are keen to work co-operatively to settle an appropriate approach to transitioning to the new Rules. In this spirit, our submission:

- Responds to the Commission's consultation paper dated 14 September 2012 in which the Commission outlined its proposed approach to applying the proposed new Rules;
- Responds to some indicative drafting issued by way of an AEMC staff paper on 25 September 2012;
- Responds to the "two determination" transitional process proposed by the Commission; and
- Draws on constructive industry discussions with AER and AEMC staff regarding variations to the model proposed by TransGrid as an alternative to the model proposed by the AEMC (the TransGrid proposal).

The NSW DNSPs understand that the Commission is interested in exploring alternative approaches to the model initially proposed by the AEMC and is in the midst of consultation with key stakeholders on a variety of options.

At this stage there appears to be broad support both by the AER and network service providers for the adoption of an alternative model(s). Further, there would appear to be broad agreement that the alternative models all meet the AEMC's policy requirements in the broadest sense; however, the degree of support for each of the models appears most influenced by concerns relating to the following three primary drivers:

- The degree of certainty that the alternative models provide for investment decisions;
- The timing of any price relief for customers that may arise from the application of the new Rules and related guidelines; and
- The procedural costs and potential pricing instability that may arise over the breadth of the regulatory period by attempting to explicitly resolve either or both of the above drivers.

The alternative approaches are all based on the inherent concept of a single determination process under the new Rules, but with the determination process delayed by one year to meet the AEMC's requirement that the new Rules should apply to as many NSPs as possible (as early as possible). This submission concentrates on addressing the principles and other considerations which should inform the Commission in determining how to approach the "placeholder revenue and pricing outcomes" for businesses and customers during the one year delay as well as the timing of the application of the new Rules more generally.

Principles for Transitioning to new Rules

Before addressing the substantive arrangements now being considered by the Commission, the NSW DNSPs would like to comment on the principles articulated by the Commission as guiding its proposed arrangements. It is clear from the consultation paper that the key driver underpinning the proposed transitional arrangements is the Commission's strong preference that the proposed new Rules should apply to as many NSPs as possible as early as possible.

Other principles referred to by the Commission (being adequate stakeholder consultation, allowing NSPs to recover their efficient costs and ensuring the practicability of the arrangements for the AER and stakeholders) essentially derive from the fact that the Commission is seeking to apply the new Rules to determination processes which have already commenced and before the various guidelines and schemes required to enable the new Rules to operate are in place.

The ENA wrote to the Commission on 10 September 2012 urging the Commission to adopt the principles underlying its past practice in relation to the transition to new Rules. In particular the ENA articulated two fundamental principles which should guide all Rule makers when determining how to apply and transition to new Rules. These are:

- People should have certainty as to the requirements that apply to them when undertaking actions, particularly where acting inconsistently with particular

- requirements has consequences (for example, non-compliance can lead to exposure to a penalty or some other kind of detriment); and

 - The fact that changes in a framework may be occurring should not result in any disadvantage to a person subject to the framework during the time that the framework is changing.

The NSW DNSPs support and endorse the above principles which were consistent with those articulated by Ausgrid in its April 2012 submission to the AEMC in response to the directions paper. It is accepted that there are strong expectations from many stakeholders for the early implementation of the amended Rules, which is a key consideration for the Commission in developing its preferred approach.

While we recognise the Commission's preference for the new Rules to apply to the NSW DNSPs at the upcoming AER determination processes, we are concerned that this preference should not be attained at the expense of due process or procedural fairness. That is, the Commission should ensure any proposed arrangements are procedurally fair and do not disadvantage the NSW DNSPs merely because of the timing of their regulatory determination processes or through the retrospective application of new Rules to conduct which has already occurred.

The potential for the NSW DNSPs to be disadvantaged by the proposed arrangements is particularly acute given the 2014-2019 determination process has already commenced, with the AER's Framework and Approach process almost finalised and the businesses being well advanced in the preparation of their expenditure forecasts and the other building blocks required to support a regulatory proposal. The Commission's proposed approach involves delay in the process which the AER has already commenced so that the determinations can be completed under the new Rules.

Under the revised determination timing, the AER determines the efficiency of the first year expenditure ten months after the expenditure has already been incurred. However, the Rules as currently drafted assume the AER assesses forecasts of expenditure based on information available before the start of the period. Consequently, the transitional Rules would also need to make some allowance for the AER's assessment of capital and operating expenditure forecasts for the transitional year.

Therefore, as a matter of procedural fairness consistent with the principles articulated in the ENA submission, the transitional Rules should require the AER, when assessing the prudence and efficiency of the DNSP's forecasts, to consider only that information which the DNSP had at the time of submitting its proposal. The Rules should also limit the use of updated information to substitute a forecast to the extent it is unrelated to expenditure decisions already made (for example to escalation of costs in forward years or in relation to capital programs or projects that have not commenced). Consistent with the various principles referred to above, the NSW DNSPs urge the Commission to adopt transitional arrangements which:

- Operate prospectively and once all the necessary supporting guidelines and schemes have been developed through a proper stakeholder consultation;
- Give sufficient time following the making of the Rules and guidelines for the businesses to consider and understand their effect and reflect their requirements in the proposals lodged by the businesses;

- Seek to minimise duplication or administrative complexity of processes or procedures in implementing additional transitional requirements;
- Implement a transparent process for the transitional year which at the same time is as simple, and mechanistic as possible;
- Are adaptable to varying business circumstances and a changeable external environment over the life of the transitional arrangements; and
- Provide predictability and stability of revenue and pricing outcomes over the length of the regulatory period including the transitional year.

Alternative Approach to Transition

We do not support the two determination approach proposed in the Commission's consultation paper, but rather support an alternative approach under which the 2014-2019 determination process for the NSW network service providers is delayed by one year to enable one determination under one set of Rules.

In our view, the Commission's initial approach is unnecessarily complex as it requires separate one year and five year determinations under two different sets of Rules at the same time as both the AER, industry and other stakeholders are participating in the development of the guidelines and schemes necessary to support the new Rules. The resources required to deliver this outcome are disproportionate to the outcome required for that first transitional year. It also creates a genuine risk of revenue and price instability which would be a poor outcome for consumers and regulated businesses alike.

Recognising such concerns, the NSW DNSPs have engaged in very constructive discussions with other network service providers and the AER to develop an alternative approach which we consider better meets the AEMC's objectives when transitioning to the new Rules.

Under the alternative approach, one five year determination will be made under the new Rules for the period 2014-2019 following the AER's completion of the guidelines and schemes required to support the new Rules. The determination will be made one year into the regulatory control period with a "look back and true up" adjustment for that first year (being the transitional year), once a determination is made for the full five year period. This approach will address the complexity and risks associated with two determination processes within a short period of time; however, it does give rise to the need to address the revenue and pricing outcomes during the transitional year 2014/15.

Attachment 1 – "Transitional Arrangements for Chapter 6" seeks to set out a balanced, reasonable and transparent process through which the AER could arrive at an appropriate revenue or price outcome to apply to the transitional year where it is required to make such a decision. This option has been developed in consultation with AER staff and as such the NSW DNSPs believe that this model represents a manageable and balanced process.

Several key principles were considered in developing the attached alternative approach. Namely it was considered that the arrangements should establish a transitional smoothed revenue/price that reflects and/or supports:

- The incorporation of as much of the new Rules as possible, including having regard to the new rate of return guidelines from the start of the next regulatory control period;
- A revenue estimate for the first year of the regulatory control period that is consistent with the smoothed revenue that is likely to be determined through the delayed full regulatory determination process;
- A medium term price path that seeks to manage price and cash flow volatility over the regulatory period; and
- Stakeholders having the opportunity to fully engage in the extensive consultation processes being conducted on the new guidelines in 2013.

Moreover, where the AER is to establish a transitional revenue amount, it should have regard to a number of factors including:

- (1) An assessment of the DNSP's range of indicative total revenue requirements and annual revenue requirements for the next regulatory control period;
- (2) The requirement that customers are no worse or better off over the transitional regulatory control period from the delay in submitting the regulatory proposal in present value terms;
- (3) The requirement that X factors determined for the remaining four years of the regulatory period recover the difference between the expected weighted average revenue for the transitional regulatory year and the determined total revenue requirement;
- (4) The desirability of minimising variations in expected revenue between regulatory periods and regulatory years;
- (5) The desirability of minimising price variations for consumers between regulatory periods and regulatory years;
- (6) Compliance with the control mechanism for the transitional year as set out in the Framework and approach paper applying to the transitional regulatory control period; and
- (7) The DNSP's statement and submissions on this statement.

The alternative transitional approach also seeks to address the range of additional matters relevant to DNSPs, and therefore were absent from the TransGrid proposal. In broad terms the additional matters (such as incentive schemes and alternative control service pricing) would be deemed to be rolled forward from the end of the current regulatory period to the degree that this default is not amended through the Framework and Approach process that applied to distribution networks. In this manner, it was hoped that ancillary decisions required for a determination would not be left without authority, whilst minimising the specific matters that need to be addressed for the transitional year.

Regarding incentive schemes, we consider that the Efficiency Benefit Sharing Scheme (EBSS) and the Service Target Performance Incentive Scheme (STPIS) should not apply in the transitional year.

Hybrid Approach to Transition

Notwithstanding the robust approach set out above for when the AER is required to make a decision regarding the revenues or process for the transitional year, further models have

been the subject of discussion across industry and with the AER and the AEMC staff. The option that would appear most robust is what has been referred to as the “hybrid” approach. The hybrid approach contains two components for setting the transitional year revenue: a purely mechanistic component and an AER decision component.

For the mechanistic component, the transitional Rules would provide for automatic approval where the revenue or price proposed by the DNSP in its statement to the AER for the transitional year was equal to or less than a reference price or revenue movement “cap” from the last year of the current regulatory period.

It would appear that there are only two viable options for the reference revenue movement that have sufficiently broad application as to be appropriate for multiple jurisdictions. The first being a CPI price movement in revenues / price from the last year of the current regulatory control period that would ensure that customers and network service providers are no better or worse off in real terms for the transitional year than they were for the year prior. The second option being a “price freeze” for the transitional year; which is consistent with existing Rule arrangements (section 6.11) where the AER was unable to make a determination in time for the next regulatory period.

Of these options, the one that would appear to have the greatest utility for a range of network service providers and would be utilised in more circumstances is the CPI option. It is also worth noting that all commercial enterprises have strong incentives to ensure that there is not a material disconnection between revenues and costs to maintain financial performance outcomes. Therefore there is clearly a strong incentive for network businesses to avoid a material difference between its transitional year revenues and that which the AER will ultimately determine as it could create significant issues, particularly towards the end of the regulatory period (noting the time value of money).

Therefore, it is reasonable to expect that under any form of alternative transitional approach, network service providers have the incentive to provide the AER with a statement for the transitional year that roughly approximates the medium term price path that the AER would have reasonably determined as part of its full determination process. This may result in distribution network price movements lower than the rate of inflation for the transitional year in some instances.

For the AER decision component, which would only apply if a DNSP lodges a statement seeking a revenue increase in the transitional year that is above the cap, the NSW DNSPs believe that the broad approach set out in Attachment 1 provides a solid foundation for a regime that could be applied in such a circumstance.

On balance, the NSW DNSPs believe that the approach which is most consistent with the high level principles set out above and which will be applicable in the most number of circumstances is a hybrid approach that:

- Provides for automatic approval of a DNSP statement that seeks revenues at or below the smoothed revenues of the last year of the current regulatory period indexed for CPI, and

- Includes the requirement for the AER to make a decision on the appropriateness of a DNSP statement that exceeds the capped amount consistent with the principles and broad approach set out in Attachment 1 to this submission.

The hybrid approach is consistent with, and would support, the objective of Networks NSW in placing downward pressure on electricity prices to target average distribution network price movements for the three NSW DNSPs as close as possible to the rate of inflation over the next six years starting 1 July 2013.

The NSW DNSPs note that there has been recent discussion regarding legal drafting of the transitional Rules on whether there should be one or two regulatory control periods under the proposed alternative approaches. While there clearly needs to be an identifiable distribution or transmission determination in place at all times to regulate revenue or pricing, it is not apparent that this necessitates two regulatory control periods. The approach most consistent with the alternative approaches would appear to be that there is one regulatory control period during which there will be the determination of a placeholder revenue or price for the first year and the distribution or transmission determination to apply to the whole period.

The only real significance of the “regulatory control period” in this context is that the right to seek merits review depends upon there being a network revenue or pricing determination “that sets a regulatory period”. Under the proposed alternative arrangement the policy outcome on merits review should be that it only arises in relation to the distribution or transmission determination for the whole period. There would not appear to be any utility or need for a right to merits review in relation to the placeholder revenue.

Retrospective Application of the Rules

Generally the AEMC’s approach is to apply the new Rules prospectively once the necessary guidelines and schemes have been developed. One area, however, where the AEMC has proposed that the new Rules should apply retrospectively, i.e. to conduct which has already occurred is the review of the efficiency of capital expenditure undertaken during the prior two regulatory control periods and the potential for over expenditure to be removed from the regulated asset base.

These provisions are proposed to be implemented by amendments to Schedule 6.2 to Chapter 6 of the Rules (for distribution), which currently provide for the automatic roll in of capital expenditure at the end of the regulatory control period. Specifically, those provisions provide for an overspending requirement to be assessed by reference to all capital expenditure incurred in the first three years of the prior regulatory control period and the last two years of the regulatory control period preceding the previous control period. These periods align with the timing for the availability of actual capital expenditure at the time of the AER’s proposed assessment.

We note and support the ENA’s submission on the general application of *ex post* reviews, its concerns with the proposed Rule and, if the Commission still proceeds with implementation, how it should operate. Our submission focuses specifically on the Commission’s consultation paper on how NSW DNSPs should transition into this framework.

Section 3.2.2 of the Commission's consultation paper indicates there would be no transition to the new Rules. Using Ausgrid as an example, the Commission outlines that when Ausgrid submits its proposal for the full regulatory control period in May 2014, the AER would consider the efficiency of Ausgrid's capex for the regulatory control period commencing on 1 July 2009 and for the interim 2014/15 year.

While this appeared to be inconsistent with the proposed approach to assess overspending by reference to a five year period straddling the prior to regulatory periods, AEMC staff have clarified in their workshop on the proposed transitional Rules on 26 September 2012 that it is not proposed to apply the Rules with respect to the review of past capital expenditure to expenditure undertaken during the previous 2004-2009 period, but that such a review will be required in relation to actual capital expenditure during the current 2009-2014 period. The effect of this proposed approach is that capital expenditure of network service providers and the way in which that expenditure is rolled into the regulated asset base will be subject to different Rules to that which were known and applied when forecasts and decisions were made in relation to that capital expenditure.

The NSW DNSPs do not support the proposed approach on both legal and policy grounds. The proposed arrangements appear to be contrary to the National Electricity Law and irrespective of their legality are inherently unfair. The National Electricity Law (NEL) provides that Rules will not commence prior to the day that notice of the Rule is published. This provision in section 103 is supplemented by the interpretation provisions in Schedule 2 to the NEL. Clause 33 of Schedule provides that the amendment of a provision of the Rules does not affect:

- "[T]he previous operation of the provision or anything suffered, done or begun under the Rules"; or
- A right privilege or liability acquired, accrued or incurred under the provisions.

The NSW DNSPs are currently operating under the Chapter 6 transitional Rules and have incurred capex in the expectation that it would be treated in accordance with those Rules which confer a right for all such capex to be rolled into the regulated asset base. On this basis, the proposed changes to the Rules to implement an efficiency review process and the potential penalty of expenditure values not being allowed into the regulatory asset base after the end of the regulatory control period cannot apply to capex incurred prior to the changes to the Rules.

Putting aside the issue of legality, the proposed approach also offends the well accepted principles for the application of new Rules discussed earlier in this submission imposing an inherently unfair process. This is because the conduct of the business will be judged and assessed (and significant financial penalties potentially imposed) following the application of criteria and standards which were not known by the business at the time the expenditure was planned and undertaken.

When this issue was raised in discussion with AEMC staff, the sentiment of the response was that "a business with good processes has nothing to fear". While the NSW DNSPs have confidence in their capital governance processes, they are not currently aware of what the AER might consider is an acceptable process until "after the fact" and indeed will not be in a

position to properly prepare for this review process until the Capital Expenditure Incentive Guidelines are in place.

Finally, the Commission has not addressed how the proposed approach could be regarded as contributing to the achievement of the National Electricity Objective. In this regard, we note that the AER's original proposal did not seek the power to conduct *ex post* reviews of capital expenditure in transitional periods.

For these reasons, the NSW DNSPs urge the Commission to reconsider its position in relation to the application of the review of capex efficiency and ensure that these provisions are not applied to any expenditure until the relevant Rule changes and the supporting Capital Expenditure Incentive Guidelines are in place. For the NSW DNSPs this will mean that a review of the efficiency of capital expenditure which could lead to expenditure being excluded from the regulated asset basis should only apply to expenditure incurred within a reasonable period after 30 August 2013. Reasonably, this should only occur to expenditure incurred after 1 July 2014. This would involve consideration of how to treat capital expenditure incurred during the transitional year when the placeholder revenue and prices are in place. It would seem appropriate that any review of expenditure be considered at the same time as years 2 and 3 of the 2014-2019 period as there would be no basis upon which expenditure in year 1 alone could be considered.

In summary, I would like to reiterate my appreciation for the constructive dialogue and collaborative discussions that have occurred to date with both the AEMC and the AER in considering alternatives to the initial AEMC transitional approach aimed at achieving one determination under one set of Rules for the orderly transition to the new Rules in a manner that is acceptable to all stakeholders.

If you would like to discuss this matter further, please contact Mr Mike Martinson, Group Manager Regulation at Networks NSW on (02) 9853-4375 or via email at michael.martinson@endeavourenergy.com.au.

Yours sincerely,



Vince Graham
Interim Chief Executive Officer

Attachment: 1 Transitional Arrangements for Chapter 6

Attachment 1 – Transitional Arrangements for Chapter 6

Key Principles

On 14 September 2012, the AEMC issued a consultation paper on the transitional arrangements that would be required to implement the draft Chapter 6 and 6A Rules. The AEMC consultation paper outlines that the upcoming round of revenue determinations would be delayed by one year, with a transitional determination required to set revenue for the 12 month interim period. To the extent that a 12 month delay to the next round of resets is both necessary and appropriate, the question then turns to how to establish prices in the intervening period.

We consider that it is desirable for the arrangements to establish a transitional smoothed revenue that reflects and/or supports:

- the incorporation of as much of the new rules as possible, including having regard to the new rate of return guidelines from the start of the next regulatory control period;
- a revenue estimate for the first year of the regulatory control period that is consistent with the smoothed revenue that is likely to be determined through the delayed full regulatory determination process;
- a medium term price path that seeks to manage price and cash flow volatility over the regulatory period; and
- stakeholders having the opportunity to fully engage in the extensive consultation processes being conducted on the new guidelines in 2013.

An alternative approach – for distribution

To the extent that a 12 month delay to the next round of resets is necessary and appropriate, the allowed revenue needs to be established for the first year of the regulatory control period, and this will need to occur prior to the full regulatory determination being made.

The current Rules already anticipate a circumstance where a regulatory determination is not made within a sufficient time for prices to be determined in the first year. In this circumstance the existing regulatory determination and prices remain in force. In the event that prices for that first year need to be adjusted, this would be “trued up” in NPV neutral terms in the remaining years of the determination.

Consistent with this approach, the process of establishing the placeholder revenue, including consulting with stakeholders, should be as streamlined as possible, in recognition of the true-up that will follow. Placeholder revenue would be determined on the basis of a statement from the DNSP submitted to the AER 5 months out from the start of the next regulatory control period. Regardless of the form of control that is to apply, it will be necessary to establish an indicative smoothed “placeholder revenue” requirement which will allow businesses to implement pricing arrangements for the assigned control mechanism in the transitional year.

The placeholder revenue statement would be supported by indicative range based information provided by the DNSP, including:

- the forecast revenue in the last year of the current regulatory control period;

- the indicative opening regulatory asset base at the beginning of the next regulatory control period
- the possible high and low range of total annual revenue requirements and annual revenue requirements for the next regulatory control period (both smoothed and unsmoothed) based on indicative inputs including:
 - a range of indicative opex forecasts;
 - a range of indicative capex forecasts;
 - a range of WACC forecasts, taking into account recent regulatory decisions, available market information, expected market trends and having regard to the rate of return guidelines;
 - an indicative CPI;
 - a summary of overall plans for expenditure over the transitional regulatory control period and an indication of how the placeholder revenue requirement fits within that plan; and
- any other inputs necessary for determining the placeholder revenue requirement or pricing arrangements for the transitional year.

The aim of this process is to establish a placeholder revenue that moves prices in a direction likely to be consistent with the full regulatory determination process. It is recognised that the first year revenue will not be determined with a level of precision. Further, to minimise the potential for unacceptable price variations to customers both between regulatory control periods and during the regulatory control period, a consideration of the medium term smoothed price path may be appropriate.

Therefore, all stakeholders have an interest in minimising avoidable differences in the placeholder revenue and the revenue path eventually determined for the regulatory control period, particularly where this difference would represent unnecessary price increases for customers.

It is expected that, to the extent they are in place, the new Rules, AER Guidelines and the Framework and Approach process would facilitate estimating the placeholder revenue. The new regulatory framework would be used for the determination of the trued-up revenue for the full five years.

There will, however, be some matters that may need to be accounted for on a transitional basis for the first year of the regulatory control period while a full determination is being determined or which remain uncertain at this stage. For DNSPs under Chapter 6, these include:

- Pass through events. Most pass through events are prescribed in the rules and they would continue to apply. The transitionals would ensure that, during the first year, DNSPs would have access to the same pass through events on the same basis as apply in the current regulatory control period. The nominated pass throughs to apply from years 2 to 5 would be determined using the new rules in the full determination.

- Certain policy and framework papers, such as a *negotiating framework*, a *Negotiated Service Criteria*, and *pricing methodology*, would preferably continue to apply until a full regulatory determination is made, where these policies and frameworks already exist.
- Distribution STPIS scheme. The transitional rules should deem a rollover of existing arrangements to occur, unless the AER makes a different determination as part of the Framework and Approach paper. For example, target for year one could be deemed to be any target that applied in the last year of the previous regulatory control period, with the same amount of revenue at risk. Normal arrangements would apply for setting targets for years 2-5 as part of the full determination – the AER would set out its proposed approach in the Framework and Approach paper.
- EBSS. Given that the expenditure target for year one of the period will not be determined until well into the year, rolling forward the EBSS is not appropriate. In addition, there is some uncertainty as to the future form of the scheme, with the ongoing application of the EBSS to be considered concurrently with the development of guidelines during 2013. The AER intends to set out its proposed approach to the application of the EBSS in the framework and approach paper process for each business – this would be confirmed in the final determination towards the end of year one of the transitional regulatory control period. Transitional rules should provide appropriate flexibility (either through the guidelines or the F&A process) for the EBSS to apply differently in the initial year of the transitional regulatory control period. For example, it may be necessary to set the target in the first year equal to the actual for the purposes of the incentive mechanism. This would allow the scheme to operate in years 2 to 5, without creating any distortions in year 1.
- Demand Management and Embedded Generation Connection Initiative Scheme (DMEGCIS) arrangements for year one would also be finalised as part of the Framework and Approach. The transitional rules should deem the following rollover of arrangements to occur, unless the AER makes a different determination as part of the Framework and Approach paper.

For part A of the scheme, the transitional rules could deem an DMIA allowance in year one of the transitional regulatory period based on the average yearly DMIA amount provided (i.e. 1/5th of the total provided) in the prior regulatory control period for the current DMIS.

Claw back amounts relating to the unused DMIA only occur in year two of the next period – so no transitional arrangement would be required. Part B of the scheme (foregone revenue related to projects approved under part A) would not be applied during year one of the transitional determination. The existing arrangements for the operation of the D-factor scheme could be continued for year one of the next regulatory control period in NSW.

If not already addressed in existing law, the transitional arrangements should ensure that carryover arrangements continue to operate – that is, benefits accrued in the existing regulatory period could be recovered in the next regulatory period where needed under the scheme. The demand management arrangements for years 2-5 would be set in the full determination process and the proposed approach would be set out in the framework and approach paper – which should allow for consideration of

the outcomes of the AEMC's power of choice review. The AER could consider applying part B from year 2, depending on the control mechanism that is set.

- any new capex incentive scheme as allowed under the draft rules would not apply in year 1 of the transitional regulatory period, but could apply in years 2-5 following the full determination.
- Connection policies will need to be dealt with on a jurisdictional basis – the intent is as far as is possible to roll-forward the arrangements from year 5 of the previous period.
- Changes to Alternative control services – to the degree that there are any changes in to the services classified as alternative control services pricing arrangements for the transitional year and for the remainder of the regulatory period would be addressed through the Framework and Approach process.
- NSW public lighting - Allowable public lighting price movements will similarly need to be addressed for the transitional year. Details concerning the treatment of public lighting will need to be addressed through the Framework and Approach process.

Timing of DNSP statement

For DNSPs whose next regulatory period commences on 1 July 2014, placeholder revenue statements should be submitted to the AER at least 5 months prior to the commencement of the transitional regulatory control period. This will ensure that sufficient time is provided for the AER to approve an appropriate revenue and for prices to be put in place prior to the commencement of the transitional regulatory control period.

Following submission of the statement on the placeholder revenue, the AER would publish an invitation for submissions from interested stakeholders.

Where the AER rejects the statement, the AER will be required to approve its own for that DNSP. Therefore, it is necessary for the AER to approve or reject the statement in sufficient time for prices to be set for the start of the regulatory control period. The AER would publish the approved statement 2 months prior to the commencement of the first regulatory year of the transitional regulatory control period.

Where the AER is to establish a placeholder revenue, it should have regard to a number of factors including:

- (1) an assessment of the DNSP's range of indicative total revenue requirements and annual revenue requirements for the next regulatory control period;
- (2) the requirement that customers are no worse or better off over the *transitional regulatory control period* from the delay in submitting the regulatory proposal in present value terms;
- (3) the requirement that X factors determined for the remaining four years of the regulatory period recover the difference between the expected weighted average revenue for the *transitional regulatory year* and the determined *total revenue requirement*;
- (4) the desirability of minimising variations in expected revenue between regulatory periods and regulatory years;

- (5) the desirability of minimising price variations for consumers between regulatory periods and regulatory years.
- (6) compliance with the control mechanism for the transitional year as set out in the Framework and approach paper applying to the *transitional regulatory control period*;
- (7) The DNSP's statement and submissions on this statement.

Other Timing Issues

Certain decisions and processes would need to be delayed for the transitional regulatory control period (that is, the first regulatory control period after the new rules come into effect).

These transitional time limits would need to be addressed in the draft rules.

It is proposed that the following decisions be delayed for 12 months for the transitional regulatory control period:

- the due date for the Framework and Approach paper and all administrative steps in the development of that paper
- the submission due date for the NSP's proposal and any required associated documents
- the making of the AER's regulatory decisions on the proposal

For NSW/ACT DNSPs, the Framework and Approach process has already commenced under the existing rules. Therefore, it is proposed that the AER could publish a part of that paper in the first quarter of 2013, rather than waiting until November 2013 which would be the due date for the paper under the proposal above.

This would cover matters where there has not been a significant change from the existing rules and where the content has already been substantially developed – classification, control mechanisms and dual function assets. To support the early publication of the Framework and Approach paper, the transitional arrangements should require the AER to segment the Framework and Approach paper into two parts and to be published at separate times. This would allow other matters to be set out in a second Framework and Approach paper in November 2013. The second Framework and Approach paper would cover incentive schemes, assessment methods and any other matters.

