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21 March 2007

Dr John Tamblyn
Chairman
Australian Energy Market Commission
Level 16
1 Margaret Street
Sydney NSW 2000

Dear Dr Tamblyn

Rule Change Proposal: Incidental transmission services undertaken by DNSPs

EnergyAustralia believes there is a disconnect in the Rules between the definition of distribution and transmission networks and the Rules which govern the economic regulation of both networks. The Rules:

- specifically allow assets owned by a DNSP to be categorised as part of the Transmission network; and
- require the economic regulation of the transmission network to be subject to different arrangements to the economic regulation of the distribution network.

The result of this disconnect is inefficient and duplicative regulatory processes. The same regulatory outcome can be achieved without the inefficiencies of using a single determination process.

EnergyAustralia has been exploring options aimed at streamlining regulatory processes. While this is a simple concept in theory, it is difficult to achieve in application without adverse market impacts. For example, amending the technical delineation of transmission networks would solve EnergyAustralia's problems, but has the potential to create significant problems for other participants and the wider market.

Our solution is to address the issue through rules relating to the economic regulation of the networks. We proposed a solution as part of our submission to the AEMC's ('the Commission') most recent review of Chapter 6 of the Rules. The Commission noted our submission but expressed a desire to consider it independently as part of a formal Rule change process. This proposal is in response to the Commission's request.

We have therefore prepared a comprehensive Rule change request which:

- Identifies the problem of inefficient regulatory process and how that problem is manifested through the Rules;
- Acknowledges that the severity of the problem is localised to distribution network regulation and therefore assesses options on the basis of addressing the problem in this context;
- Demonstrates how the proposed Rule will promote the other objectives against other alternatives (including the status quo);
- Is supported by independent scrutiny and analysis (PB Associates) of options and consultation with stakeholders; and

- Identifies the Rules that require amendment and suggests drafting to guide the AEMC when addressing the Rule change.

This Rule change proposal supersedes that which EnergyAustralia lodged with the AEMC on 5 January 2007 and has been amended following discussions with your officers and other stakeholders.

Unfortunately time is not on our side. We began preparations for our next process for determining network revenues at the end of last year. Significant delay in this Rule change would mean we would not be able to revisit this issue until 2014. The urgency to resolve this problem justifies an expedited Rule change under Section 96 of the National Electricity Law.

If you have any queries or comments regarding this proposal, please do not hesitate to contact me on (02) 9269 4171.

Yours sincerely

Harry Colebourn
Executive Manager – Network Regulation & Pricing

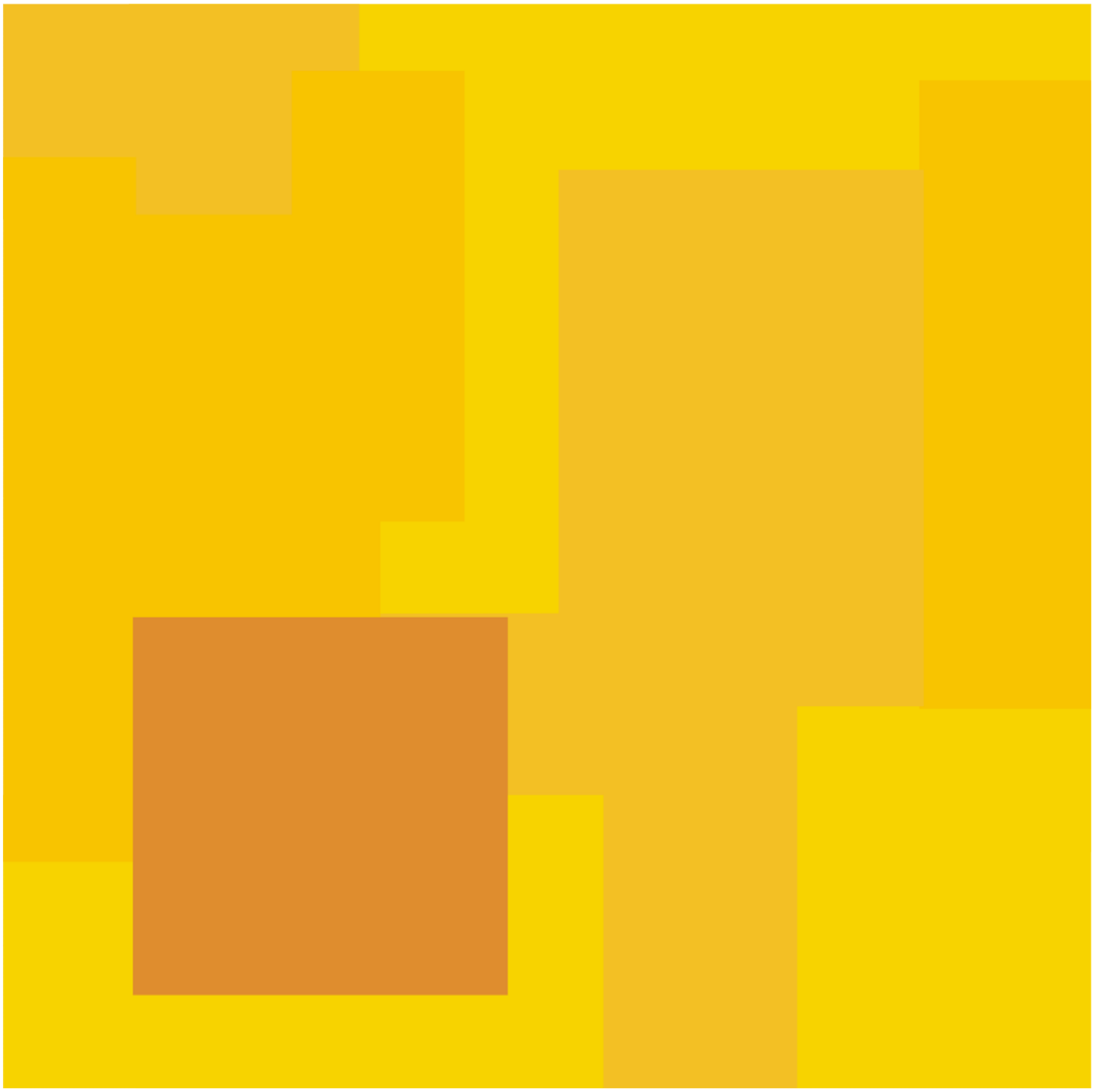
Attachments

EnergyAustralia™

Rule change proposal

Incidental transmission services provided by DNSPs

MARCH 2007



Contents

1 Introduction

In 1999 and 2004, EnergyAustralia was subjected to two regulatory determinations for its single electricity network. The ACCC scrutinised assets and related expenditure that fell under the definition of transmission network. IPART scrutinised those assets and related expenditure defined as part of the distribution network. However, changes to the configuration of both TransGrid's and EnergyAustralia's network mean that network assets will move in and out of asset categories over time. A significant level of duplication and inefficiency has therefore been evident in the undertaking of two concurrent reviews.

This problem will be exacerbated when responsibility for economic regulation of all electricity networks rests with the same regulator. We expect that is problem is also likely to occur with other distribution network owners, if it hasn't already.

EnergyAustralia has been exploring options aimed at streamlining regulatory processes. While this is a simple concept in theory, it is difficult to achieve in application without adverse market impacts. For example, amending the technical delineation of transmission networks would solve EnergyAustralia's problem, but has the potential to create significant problems for other participants and the wider market.

Our solution is to address the issue through rules relating to the economic regulation of the networks. We proposed a solution as part of our submission to the AEMC's ('the Commission') most recent review of Chapter 6 of the Rules. The Commission noted our submission but expressed a desire to consider it independently as part of a formal Rule change process. This proposal is in response to the Commission's request.

We acknowledge the Commission's most recent guidelines[1] to assist proponents in preparing submissions. We also support the Commission's desire for a rigorous approach to evaluating Rule change proposals[2]. We have therefore prepared a comprehensive Rule change request which:

- Identifies the problem that needs to be addressed and how that problem is exemplified in the current Rules;
- In light of the severity of the problem assesses options on the basis of addressing the problem and the impact on the wider market;
- Demonstrates how EnergyAustralia's proposed solution will promote the NEM Objective against other alternatives (including the status quo);
- Is supported by independent scrutiny and analysis of options and consultation with stakeholders; and
- Identifies the Rules that require amendment to enable EnergyAustralia's proposed solution and suggests drafting to guide the AEMC when addressing the Rule change.

Unfortunately time is not on our side. We began preparations for our next process for determining network revenues at the end of last year. Significant delay in this Rule change would mean we would not be able to revisit this issue until 2014. The urgency to resolve this problem justifies an expedited Rule change under Section 96 of the National Electricity Law.

[1] AEMC "Guidelines for Proponents: Preparing a Rule change proposal" March 2007
[2] AEMC Draft Rule Determination "Abolition of Snowy Region", p9

2 Summary of Proposal

2.1 Person making the Rule request

EnergyAustralia is a statutory State Owned Corporation constituted under the Energy Services Corporations Act 1995 (NSW) and is also a Registered Participant in the National Electricity Market. EnergyAustralia's address is 570 George St Sydney NSW 2000.

2.2 The problem that needs to be addressed

The problem is the inefficiency of duplicate regulatory processes that EnergyAustralia is subject to as a result of a technical classification of part of its network. The same regulatory outcome can be achieved more efficiently with a single determination process.

The intent at the time of drafting the original Code was to ensure that market and transmission pricing signals would be passed through in full to all connections to the meshed transmission network. Whilst this economic consideration is still valid, the full extent of added complexity to the regulatory processes was not envisaged. It is now unavoidable because the Rules:

- specifically allow assets owned by a DNSP to be categorised as part of the Transmission network;
- require the economic regulation of the transmission network to be subject to different arrangements to the economic regulation of the distribution network.

2.3 Statement of issues – how the problem is exemplified in the Rules

There is a disconnect in the Rules between the definition of distribution and transmission networks and the Rules which govern the economic regulation of both networks. The definitions result in part of EnergyAustralia's (and other DNSPs') distribution network being reclassified as part of the transmission network because of its technical characteristics. Existing distribution assets may, due to development of the network, acquire the technical characteristics of transmission assets in the middle of a regulatory period, resulting in their reclassification at the beginning of the next period (and vice versa). Despite this anomaly, the Rules governing the economic regulation of distribution and transmission networks assume a clear delineation between these services.

This results in duplicative, ambiguous and non-transparent economic regulation of networks where these conditions exist. The regulatory framework is left to cope with assets, intermeshed throughout the distribution network, moving in and out of the transmission network classification based on the configuration in which they are normally connected.

Further detail of how the current Rules lend to the problem for EnergyAustralia and for other owners of distribution network can be found in section 2.

2.4 Market impacts

At this stage the problem is explicitly inherent in EnergyAustralia's network. The economic inefficiency suffered by EnergyAustralia and the AER is sufficient to warrant changes to the Rules. The problem will also affect other distribution businesses now, or in the future. However, the overall impact in the context of the entire market is likely to be at the margin.

Given the problem is localised to distribution network regulation and does not directly impact wider market issues, we seek changes to the Rules that specifically address the problem without impacting other market participants. The solution therefore does not seek to alter the technical operation of the network or the market or materially change customer pricing arrangements.

Our approach to doing this is expanded in Section 3.

2.5 EnergyAustralia's proposal to address the problem and description of proposed Rule

EnergyAustralia proposes a Rule change which addresses the problem described above by:

- Specifically recognising that assets built for the purpose of operating the Distribution network, may serve a function of supporting the Transmission network;
- Where this occurs, providing the option for a DNSP to apply to the AER to have such assets subject to the same arrangements as the rest of the distribution network for revenue regulation; and
- Requiring the AER to approve the application if certain criteria relating to the role of the assets and impacts on the NEM are satisfied.

In order to minimise any potential adverse affects to the wider market, EnergyAustralia proposes that the regulator be conferred with discretion determine whether assets forming part of the transmission network and approved for regulation under the rules for distribution should be priced separately under the transmission pricing regime.

The proposed Rule is described in detail in section 3. EnergyAustralia notes that a request for a Rule may, but need not, be accompanied by a draft of the requested Rule. A suggested form of drafting to achieve the proposed rule is set out in Appendix 1. However EnergyAustralia acknowledges that the drafting of the Rule and its placement within Chapter 6A or elsewhere in the Rules are essentially matters for the AEMC.

The proposed Rule has been drafted as an amendment to clause 6A.1.4 as this clause currently provides limited scope for network service providers and regulators to deem certain assets to be subject to alternative regulatory arrangements. EnergyAustralia notes however that this clause was carried over following the review of Chapter 6 without review or substantive change. EnergyAustralia's proposed Rule does not otherwise seek to amend 6A.1.4, given that the current provisions apply to assets already classified as distribution. Any revision of these provisions should occur as part of the rules for distribution currently being prepared though MCE processes.

2.6 Analysis of the problem and EnergyAustralia's proposal to address the problem

EnergyAustralia has analysed a variety of options in the context of the NEM Objective. A detailed explanation of how the proposed Rule will or is likely to contribute to the achievement of the national electricity market objective is set out in Section 5.

We have also evaluated the effects of the option we consider best promotes the Objective:

- by engaging independent advice on the effects of the proposal against the base case (status quo) option; and
- by evaluating effects on customers under different pricing options.

This analysis confirms EnergyAustralia's approach to this Rule change.

2.7 Seeking stakeholder views

EnergyAustralia has held high level discussions with the AER, other NSW DNSPs, TransGrid and the AEMC on this issue prior to formalising its Rule proposal.

2.8 Expediting the Rule Change under Section 96 of the NEL

EnergyAustralia requests that the proposed Rule change be expedited on the basis that it is urgent and non-controversial. Section 96 of the *National Electricity Law* allows the AEMC to make a Rule within 4 weeks from the date of publication of a notice under Section 95 if it considers that the request is for a non-controversial Rule or an urgent Rule. EnergyAustralia believes that this proposal is both urgent and non-controversial, however if the AEMC does not form the view that the proposal is non-controversial, EnergyAustralia submits that the Rules remains urgent and should be expedited on that basis alone. Section 5 sets out the basis for EnergyAustralia's request for expedition.

2.9 Subject Matter of the Proposed Rule

The subject matter of the proposed Rule relates to transmission system revenue and pricing and distribution system revenue and pricing. These matters are clearly within the AEMC's Rule making powers, being specifically itemised in Schedule 1 in items 15-24 and 25-26.

3 Issues Concerning Existing Rules

This section:

- provides a statement of issues concerning the existing Rules
- details the current operation of the regulatory framework using the existing Rules; and
- outlines the implications for the market

3.1 Statement of Issues concerning existing Rules

As noted above, there is a disconnect in the Rules between the definition of distribution and transmission networks and the Rules which govern the economic regulation of both networks.

- The Rules definition of transmission network accommodates the reclassification of part of the distribution network as a transmission network asset. The distribution network is defined as anything that is not part of the transmission network.
- The Rules which regulate the economic regulation of distribution and transmission networks assumes a clear delineation between these services. Both the AEMC and MCE have attempted to differentiate the regulatory frameworks on the basis of their differing roles in the National Electricity Market.

From a definitional perspective the Rules allow for a single asset built for the purpose of supporting the distribution network to be classified as part of the transmission network if certain conditions are met. From a regulatory perspective, the Rules are quite rigid in the economic regulation of distribution and transmission networks and are not specifically designed to accommodate the movement of assets between network classes (especially when intermeshed within DNSP's network).

This has obvious implications for EnergyAustralia and other DNSPs in similar circumstances. We highlight the EnergyAustralia case study and possible implications for other DNSPs below.

3.2 Current delineation of Transmission and Distribution Networks

Chapter 10 (Glossary) of the National Electricity Rules (NER) defines the transmission network as follows:

> *A network within any participating jurisdiction operating at nominal voltages of 220 kV and above plus:*
>
> *(a) any part of a network operating at nominal voltages between 66 kV and 220 kV that operates in parallel to and provides support to the higher voltage transmission network*
>
> *(b) any part of a network operating at nominal voltages between 66 kV and 220 kV that is not referred to in paragraph (a) but is deemed by the AER to be part of the transmission network.*

Chapter 10 also defines the distribution network as:

> *A network which is not a transmission network*

These are largely technically definitions with some functional elements, but they do not distinguish between distribution and transmission assets on the basis of their role in an integrated electricity network. For example, the definitions do not convey that the transmission lines are those which deliver electricity from generators to load centres, where it can be transformed to a lower voltage for conveyance on the distribution network to end use customers. The definitions recognise that some assets will support the transmission network by their operation and thus they are then defined as transmission assets themselves. However the definitions do not recognise that:

- these supporting assets may be owned and operated by a DNSP;
- the assets may have initially been built to provide distribution services; and
- classifying these assets as transmission may have implications for the DNSP business.

The potential overlap in the operation of distribution network assets as transmission assets is explained in more detail below.

In their current form, the definitions, together with the existing clause 6A.1.4 of the Rules, provide some opportunity for assets operating at voltages of between 66kV and 220kV to move between transmission and distribution classification. However these provisions operate somewhat awkwardly and, in effect, only provide for assets operating at between 66kV and 220kV which would not otherwise be classified as transmission to be so classified (see subclause (b) of the definition above) and to be deemed back as distribution assets (see clause 6A.1.4(b)).

These provisions do not address the situation where part or parts of the distribution network are classified as transmission because of the role those assets have in the integrated network system.

3.3 Clause 6A.1.4 of the Rules

As far as EnergyAustralia can ascertain, Clause 6A.1.4 was one of the few clauses bought over to Chapter 6A from the old Chapter 6 of the Rules substantively unchanged and without review or consideration of its appropriateness. It states:

> *"Subject to the agreement of the AER and the relevant Jurisdictional Regulator, those parts of a transmission network operating at nominal voltages between 66 kV and 220 kV that:*
>
> *(1) do not operate in parallel to; and*
>
> *(2) do not provide support to,*
>
> *the higher voltage transmission network may be deemed by the relevant Transmission Network Service Provider to be subject to the regulatory arrangements for distribution service pricing set out in Parts A and B of Chapter 6."*

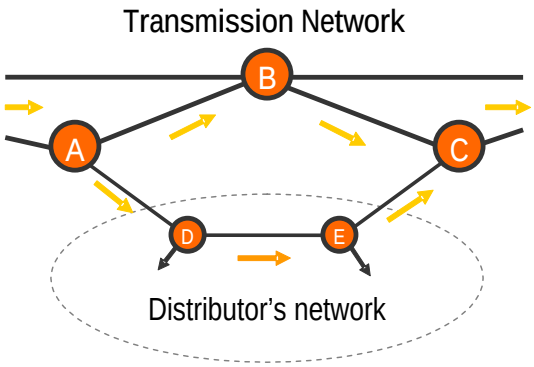
As explained above, this clause on partly addresses the problem of whether the network has been appropriately classified. It effectively allows assets that would not normally fall under the definition of transmission network but deemed to do so by the AER (under part (b) of the definition) to revert back to distribution pricing arrangements.

That is, the only assets the AER can deem to be subject to distribution arrangements are distribution assets which would not fall under the definition of transmission network in the first place. The Clause currently provides no relief for a DNSP who owns assets that fall within the definition of transmission network because they operate in parallel with and support the higher voltage

transmission network, irrespective of the fact that they primary purpose is to support the distribution network.

3.4 Potential overlap for assets that support both the Distribution and Transmission networks

The transmission network is meshed and characterised by having "tidal" flows of electricity. That is, a change in either the load or the generation at any location will change the flow in every line in the network. This brings about the potential for overlap in the functional attribute of any one particular asset (as shown diagrammatically below):



Substations A, B and C are owned by a TNSP and are part of the main transmission grid. Substations D and E are built by the DNSP for the purpose of ensuring reliable and secure supply to distribution customers. However, the lines which connect substations D and E create a loop and electricity flows between Transmission substations A and C through that loop. Therefore, while the principal purpose of substations D and E is to support the distribution network, the these substations and connecting lines take on a transmission function by virtue of the fact they operate in parallel and provide support to the transmission network.

This is a simplified illustration of what can be a complex array of loop flows where transmission and distribution network assets meet at the margin. These instances are most common in urban and densely populated areas where the distributor's network is interconnected between higher voltage transmission substations to provide the required levels of security of supply to distribution customers.

From a technical perspective this dual functionality has no impact. In the example above, substations D and E are operated by the DNSP as part of its obligations for the distribution network. The TNSP operates its own network and the flows from A through C acknowledging the loop flows through the distribution network. The planning, operation and maintenance of all of the assets which form the transmission network is closely coordinated between the owners of the assets and by NEMMCO, to ensure that the overall integrity of the transmission network is maintained.

The classification of distributor's assets as transmission follows the configuration of the network, with assets on normally closed parallel paths being included in the transmission network where there are significant transmission flows through them and they thus perform a support function. There is a small element of judgement in the classification and this aspect was reviewed by independent consultants at the time of the 2004 regulatory reviews.

Irrespective of what delineation is made, there is likely to be some overlap at the margin of some assets that will operate a dual function of both constituting the low voltage distribution network and supporting the higher voltage transmission network.

This is a challenge from an economic regulatory perspective which assumes a clear delineation between transmission services provided by a TNSP and distribution services provided by a DNSP.

In summary, a change to the technical attributes of definitions of these assets in the Rules will be difficult to achieve and may create more harm than good. A more pragmatic solution is to resolve the overlap through Rules relating to the economic regulation of the networks.

3.5 Implications for Economic Regulation of Transmission and Distribution Networks

Despite the similarities of assets at the margin, the economic regulation of transmission and distribution networks is subject to different regulatory regimes. The Rules that govern the regulation of these networks are likely to remain significantly different in terms of process and methodology. As a consequence the scope for the regulatory processes to be integrated or streamlined, even with a single regulator will be very limited.

This is obviously concerning for DNSPs who own transmission assets which are totally incidental to its DNSP operations. Such DNSPs would be subject to two very different regulatory regimes and processes for the same network, arbitrarily separated on the basis of whether it provides support to the high voltage transmission network at a particular point in time.

However, even if the regulatory regimes were exactly the same, the problems associated with separating a single network functionally into assets that support high voltage transmission and those that don't would still remain.

Undertaking two separate revenue cap application and determination processes increases (unnecessarily) the regulatory burden, resulting in increased compliance and administration costs. At the same time, the decision-making resources and capacity of relevant regulators, as well as other market participants, are inefficiently absorbed as a result of the duplicated processes

Under this regime, far more scrutiny is required in preparing and assessing what amounts to an arbitrary allocation of costs into respective network classes, rather than focussing on the underlying costs themselves. This regulatory arrangement is therefore not only duplicative and inefficient; it challenges the integrity of the underlying regulatory framework.

3.5.1 EnergyAustralia Case Study

The full application of the National Electricity Code following the expiry of derogations in February 2000, resulted in some of EnergyAustralia's assets being categorised as part of the transmission network for the first time.

EnergyAustralia is currently the only DNSP in an unenviable position of being subject to two regulatory regimes that are subject to reset at the same time. This is unnecessary and duplicative, given that the classification of the assets as transmission is totally incidental to EnergyAustralia's provision of distribution network services.

The impact of EnergyAustralia having to undertake two separate and simultaneous revenue cap processes is described below.

- It has resulted in a significant level of duplicated work being done by EnergyAustralia in order to present submissions to comply with the requirements of both processes. This is done at considerable administrative and compliance cost. This is arguably an unnecessary and unjustified regulatory burden which has the potential to divert EnergyAustralia's resources away from service provision to customers undermining the NEM Objective.

- Where the AER will eventually be undertaking both transmission and distribution revenue cap determinations, the duplicate processes will similarly create an unnecessary and inefficient process with considerable redundancy, whereby the AER will have to consider EnergyAustralia's revenue cap determination material twice, and undertake separate consultation and other processes even though Energy Australia operates as an integrated business.

The need to have two separate processes to determine EnergyAustralia's distribution and transmission revenue allowances also potentially imposes an unnecessary and inefficient burden on other NEM participants wanting to participate in the EnergyAustralia's respective revenue cap determination processes.

3.5.2 Independent Review of Approach – PB Associates

EnergyAustralia engaged PB associates to undertake an independent review of current regulatory practice to ascertain whether there perceived duplications could be overcome by moving to a single regulatory process. PB concluded that the inefficiencies and duplication of undertaking two regulatory reviews are sufficient to warrant a change to the framework:

"The differences in the regulatory frameworks for the determination of annual revenue requirements for distribution and transmission services, are minor. Moreover, the differences in these frameworks are expected to diminish, or even potentially cease to exist, as the economic regulation of electricity distribution transfers to the AER and the efforts are made to improve the integrity and consistency of regulatory processes. Nevertheless, distribution service providers having assets deemed to be transmission under the Rules (which are incidental to the provision of distribution services) are still required to undergo two distinct and separate regulatory reviews.

Two separate and distinct regulatory reviews would seem to lead to the duplication of a

number of regulatory process elements. This include, but are not limited to, the following:

• regulatory submissions by the businesses;

• information requests and financial models;

• the regulator's own analysis;

• regulator's consultant reports;

• publication of discussion papers;

• public forums and third party submissions; and

• reviews of costs and public submissions." [3]

[3] PB Associates "Economic Regulation of Transmission Services undertaken by a DNSP" an independent review p7

3.5.3 Impact on other DNSPs

This is not an issue solely for EnergyAustralia. Other DNSPs are also likely to own and operate assets that technically should be categorised as part of the Transmission network. In NSW, both Country Energy and Integral's networks currently comprise 132 kV circuits that are likely to meet the transmission definition either now or in the future. We understand that these assets are currently treated with their other assets which are subject to distribution regulation.

While this makes practical sense, there is no formal mechanism or instrument that allows this to take place should any part of their network be deemed, now or in the future, to be part of the transmission network.

There is an exception to this in Queensland where there is a derogation which precludes assets owned by a DNSP from being part of the transmission network. Section 9.32.1 of the Rules defines the Queensland *"transmission network"* as:

> *…the transmission network assets are to be taken to include only those asset owned by Powerlink Queensland or any other Transmission Network Service Provider that holds a transmission authority irrespective of the voltage level and does not include any assets owned by a Distribution Network Service Provider whether or not such distribution assets are operated in parallel with the transmission system.*

The effect of this definition is to classify all of the 132 and 110 kV assets in that jurisdiction as distribution assets, although their function in many cases is to operate in parallel with and support the 275 kV transmission network.

Therefore with the exception of Queensland, most other distributors have the potential to become inadvertent owners of transmission network assets. The same duplicative and redundant regulatory regime that applies to EnergyAustralia is likely to apply to other networks in the future.

4 The Proposed Rule and how the issues will be addressed by the Proposed Rule

This section describes the proposed Rule change, how it addresses the issues with the current Rules and explains in detail how each element will operate.

EnergyAustralia proposes a Rule change which addresses the issues above by:

- Specifically recognising that assets built for the purpose of operating the Distribution network, may serve a function of supporting the Transmission network.
- Where this occurs, providing the option for a DNSP to apply to the AER to have such assets subject to the same arrangements as the rest of the distribution network for revenue regulation.
- Requiring the AER to accept the application if certain criteria relating to the role of the assets and impacts on the NEM are satisfied.
- Allowing the AER to determine whether transmission pricing arrangements should apply to those assets that are defined as part of the transmission network.

4.1 Expansion of 6A.1.4 to include DNSPs and a new Sch 6A.4

The proposed amendment is to in insert a new 6A.1.4(c) to provide for a DNSP with a right to apply to the AER to have services provided by its distribution network but which are classified part of the transmission network subject to economic regulation under Rules for distribution. A new Schedule 6A.4 will set out how the application must be assessed and the regulatory arrangements which subsequently apply.

The outcome of this is that the AER assesses the network once, rather than arbitrarily allocating the network into 2 notional asset bases and reviewing each asset base separately. It is our experience that under the latter approach, considerable resource and effort is dedicated to whether the allocation of the network into the respective asset bases is appropriate, rather than whether the network investment overall is appropriate. This Rule change attempts to focus the regulatory framework in the right areas.

PB Associates notes that a single process "…would result in the elimination of procedural directions and a simplification of the process. This in turn would increase process efficiencies and lower costs – both for the businesses and for the regulator." [4]

Three new definitions have been introduced for the purposes of the new Schedule 6A.4 for ease of reference and to simplify drafting. These are:

"single revenue determination application" which is the application under clause 6A.1.4(c).

"dual function assets" to refer to the assets which are the subject of an application under 6A.1.4(c).

"approved dual function assets" which are dual function assets which have been the subject of a single revenue determination application approved by the AER.

[4] PB Associates "Economic Regulation of Transmission Services undertaken by a DNSP" an independent review p18

4.2 Process for making and determining an applicaton under 6A4.1.(c).

The proposed Rule provides for an application to be made 16 months before the expiry of the current regulatory period applicable to the transmission determination in force at the time of the application.

If the assets involved are not currently the subject of a transmission determination, then the application must be made 16 months before the expiry of the of the regulatory control period applicable to the DNSP's distribution system at the time the application is made. The formulations are slightly different because currently neither the NEL or the Rules have the concept of a "revenue" determination in relation to DNSPs. The Rule also provides for the unlikely circumstance that an application is being made before either a transmission or distribution determination has been made in relation to the DNSP's distribution or transmission system.

Generally these timeframes reflect the need for the classification of assets to be settled well before a revenue proposal must be submitted. However provision has been made for the AER to approve a shorter time frame. This will enable an application to be made as part of the regulatory determination process if it is ascertained during that process that it is appropriate for assets classified as transmission to be the subject of a distribution determination.

The application must contain sufficient information to enable the AER to determine whether to approve the application and the appropriate pricing arrangements to apply. There is also a requirement for the application to comply with any specific guidelines issued by the AER regarding cost allocation where a DNSP is making an application under clause 65A.1.4(c). If necessary, the AER will be able to use its existing information gathering powers to request further information to enable it to be satisfied that the critieria have been met.

The proposed Rule provides for a 20 business day consultation period and for the application to be determined within 60 business days.

Once the application criteria (discussed below) is satisfied there is no need for any further judgement or discretion to be exercised regarding whether the assets should be regulated under a single determination process. Therefore the AER will be required to approve the application if it is satisfied that certain criteria have been met and will be deemed to have approved the application if it has not been determined after 60 days. The deemed approval provision has been included to provide some certainty for the preparation of revenue proposals. The 60 day application period provides ample time for the AER to form a view as to whether or not the criteria is satisfied and whether it should refuse the application.

4.3 Criteria for assessment of application

The criteria which must be satisfied before the AER is required to accept the application include the following:

- that the assets falling under the definition of "transmission network" are incidental or consequential to the DNSP's operation of a single distribution network.
- that the relevant assets have no impact on the operation of the NEM and that the change in status would not have any adverse implications for the technical operation of the transmission and distribution system or the integrated NEM system.

The concept of "incidental or consequential" to the DNSP's distribution network is defined by reference to assets which were established as a necessary part of the distribution network which

either from the time they were established, or at some subsequent time, functioned to provide support to the transmission network. This would ensure that transmission assets acquired or established by a DNSP business for purposes unrelated to its DNSP network could not be caught by the provision.

EnergyAustralia cannot think of an instance where the change in the economic regulation of an asset would have an impact on the operation of the market or the technical operation of the network. Nevertheless the head of consideration has been included to ensure that all possible matters can be raised and considered during the application process.

4.4 Optionality for DNSP

A DNSP is not obliged to make an application under Clause 6A.4.1(c). Rather the clause is triggered on application to the AER by the DNSP. If the DNSP does not make an application, its transmission network will be regulated separately. This provides flexibility for the DNSP and AER in assessing whether an application should be made by a particular business.

EnergyAustralia wants to ensure the Rule caters for a range of scenarios including one where the AER identifies assets that should be classified as part of the transmission network while assessing a DNSP's revenue proposal. In this case the AER may allow the DNSP to make an application during the regulatory determination process.

4.5 Regulatory Arrangements which apply to approved *dual function assets*

If an application is approved by the AER or deemed to be approved by the AER, then the services provided by the assets the subject of the application will be regulated under Chapter 6 of the Rules. No reference has been made to the specific Parts of Chapter 6 given that Chapter 6 is currently under review by the MCE and is likely to be substantially amended before the end of this year.

It will also be open to the AER to determine whether alternative pricing arrangements should apply. The alternative pricing arrangements can be the application of Part J of Chapter 6A and or the preparation of a negotiating framework under Chapter 6A. If Part J of Chapter 6A is determined to apply, the Rule makes provision for:

- the determination of an Annual Building Block Revenue Requirement; which in turn enables ;
- the determination of a Maximum Allowed Revenue; which then functions as
- the aggregate allowed revenue requirement for the purposes of clause 6A.22.1 in Part J.

The policy issues arising in relation to pricing which have informed the provision in relation to the application of Part J are discussed in more detail below. In relation to the negotiating framework, the AER will determine if a negotiating framework is required in relation to the services provided by the particular assets. If such a framework is required in relation to the services provided by the particular assts, it may be appropriate for the framework to be developed and operate under Chapter 6A rather than Chapter 6.

4.6 Adjustment made at the beginning of the next distribution regulatory control period

If this Rule proposal proceeds, it is likely that current arrangements would continue to apply until the next review. The proposed changes allow for the transition between regulatory frameworks at the

end of the current regulatory control period. Provision is also made for the (unlikely) scenario where the regulatory control periods are not aligned. This eliminates the need for a complex process of revoking and reopening revenue determinations during the regulatory control period.

As this affects the economic regulation of the services provided and not the technical aspects, the Rule change would have no flow on affect to other parts of the Rules. For example provisions surrounding connection, network planning and the regulatory test would continue to operate as normal.

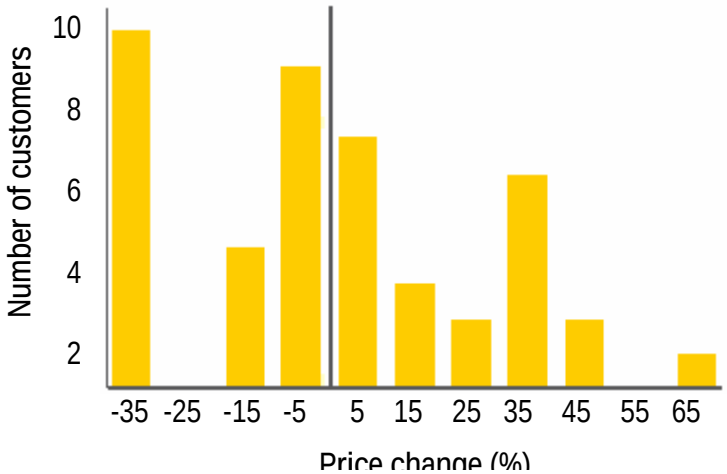
4.7 Pricing implications

As noted above, while the proposed change to the existing Rules will remove significant duplication and improve efficiencies in the regulatory process (thus promoting the NEM objective), the marginal benefit is likely to be minimal for the wider National Electricity Market. EnergyAustralia believes that any solution to its problem must be measured – ie the flow on impacts to the market and to customers must be proportional to the size of the problem at hand.

Pricing arrangements for the transmission and distribution network are in themselves an allocation exercise. However the frameworks differ significantly. The pricing framework for distribution recognises the large customer base and size of the network. The Commission has noted that a transmission pricing framework considers both locational factors and externalities associated with the use of the transmission network.

For example, EnergyAustralia has 7 customers that are directly connected to the transmission network and almost 60 large customers with individually calculated prices, for whom the transmission cost is a major component of their network bill. Any change to the pricing allocation, and particularly one that influences the transmission component (or substitutes a distribution charge for part of the transmission charge), will affect these customers in diverse ways.

EnergyAustralia undertook a high-level analysis of the likely impact on customers if pricing allocation was to be affected as a result of this Rule change. The results are produced below:



The above table demonstrates a distribution of outcomes that range from minimal impact to considerable impact as a result of these changes. This is because pricing under a transmission

framework reflects "…the strong externalities and economies of scale and scope that arise in a transmission network, which mean that particular assets may provide multiple services"[5]. Many of the customers represented in this analysis would be profoundly impacted if any Rule change resulted in this level of price change. EnergyAustralia believes that the benefits of streamlining regulatory processes between DNSPs and the AER are insufficient to justify the pricing impacts to customers of this magnitude. This is especially the case for large users who have made locational investment decisions based on the existing pricing frameworks.

While changes to pricing frameworks would represent a wealth transfer either between networks or across classes of customers, any material change to the status quo is likely to draw unfavourable response. Large customers are very price conscious and can be expected to react strongly if a change to the cost allocation increases their price. This is likely to be seen by Regulators as a retrograde step in the provision of cost reflective price signals to market participants and therefore would run contrary the NEM Objective.

The potential price variability imposed on customers as an impact of the Rule change would not be proportionate to the problem identified by EnergyAustralia. It also runs contradictory to fundamental principles adopted by the Commission in its consideration of other reforms (we discuss this in further detail when addressing how our Rule proposal addresses the NEM objective).

As a minimum, EnergyAustralia has sought to ensure any Rule change should not materially impact pricing for customers who have made investments based on existing locational signals.

4.8 Allowance for the AER to consider pricing

As noted above, there may be compelling reasons to allocate revenues associated with transmission network assets according to transmission pricing Rules. At the same time if the DNSP owned only a small amount of transmission assets the advantage borne by a separate pricing regime may be negligible. There will be no hard and fast rule that will determine the appropriateness of a particular pricing regime in all circumstances.

The Rule therefore affords discretion on the AER to determine whether assets forming part of the transmission network and subject to distribution Rules should be priced separately under the transmission pricing regime. Factors that the AER should take into consideration in assessing whether transmission assets should be subject to a separate pricing approach to distribution include:

- The value of the assets classified as part of the transmission network (for example a single asset worth $1 million is unlikely to warrant a separate pricing mechanism);
- Regulatory impediments (if any) to implementing such a method (while EnergyAustralia is not aware of any, there may be jurisdictional or licence obligations that may preclude this option);
- Customer impacts (the AER may consider that the adverse impact on a particular customer or customer class does not warrant a separate pricing regime for transmission).

[5] AEMC Rule Determination for National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 p33

4.9 Regulatory arrangements where transmission pricing is allowed

Where the AER determines that it is appropriate for separate pricing treatment of assets forming part of the transmission network, the revenues need to be firstly apportioned and then separated into each pricing methodology. The proposed Rule also provides for inclusion of the revenue component associated with those assets into the transmission revenue requirement for the purposes of part J of Chapter 6A.

The Rules will need to allow for the building block revenues built up under a distribution determination to be apportioned between transmission and distribution components for the purposes of pricing. This will require extracting the revenue associated with transmission for each building block component using an appropriate allocation methodology. The allocation process would resemble what is currently done now, but would be done after the review of expenditure and the calculation of building blocks is made not before.

The AER may need to provide additional guidance on this allocation approach in its guidelines.

The AARR used in part J of Chapter 6A will reflect this allocation. Further any adjustments made to the revenue determination will also be allocated using the same approach to ensure the impact of those adjustments relative to transmission flow through to the pricing regime.

4.10 Consequential amendments to other parts of the Rules: adjustment to the regulatory asset base

Clause S6A.2.1(f)(8) currently allows for the adjustment of a TNSP's asset base for past capital expenditure which was not previously included in the Regulatory Asset Base, but which is subsequently used for the provision of prescribed transmission services.

Should the DNSP elect to have two separate regulatory regimes for its distribution and transmission assets, this clause will be important to ensure the TNSP's RAB can be adjusted for any distribution assets that change classification to transmission. In the context of this Rule change, a minor consequential amendment to sub paragraph (f)(8) would be to refer to the "value" of prior capital expenditure, similar to what is provided under the previous sub paragraph.

This minor amendment is necessary even if the Commission decides not to accept EnergyAustralia's other proposed changes.

5 The NEM objective

The relationship between regulation and the promotion of efficient investment in, and efficient use of, electricity services for the long term interests of consumers has been discussed in a number of forums.

The Expert Panel note that "…a central goal of energy policy is to ensure that the regulatory, institutional and governance arrangements are designed to facilitate efficient investment, operation and usage decisions in the sector in order to improve the efficiency, price and reliability of energy services outcomes for the benefit of the Australian economy and the well being of all Australians."[6].

Importantly the Expert Panel noted that an important factor in policy consideration is the "…potential for significant costs and inefficiencies to arise from both the exercise of market power and the application of regulation"[7]. The Panel stated that the net benefit from regulation is maximised by ensuring that:

- Regulation is only imposed where necessary;
- The regulatory regime minimises the cost of regulation; and
- The regulator is equipped to undertake the regulatory task

Both the MCE and AEMC acknowledge the Expert Panel's focus on efficient regulatory regimes as an integral part of efficient energy markets.

The MCE notes that the regulatory regime is a critical factor driving the decisions on investment and this contributes to the long term interests of customers.[8] The Commission has previously noted that efficient regulation depends on:

> *…the degree to which the framework provides clear obligations for the [regulated business] and the regulator in rules regarding both the methodology of, and process for, regulatory decisions, while also providing for flexibility and discretion where it may be needed.*[9]

For these reasons, the Rule proposal will contribute to the achievement of the NEM objective by creating a more certain and transparent regulatory environment, while minimising impacts for the market and consumer outcomes. We believe the proposed Rule changes provide the appropriate balance between transparency through codification of process and guided regulatory decision-making in areas of uncertainty.

EnergyAustralia believes the proposed changes to Clause 6A.1.4 are also likely to contribute to the NEM Objective of promoting efficient investment in and efficient use of electricity services for the long term interest of consumers. It achieves this in the following ways:

- It removes any ambiguity associated with the regulation of assets that support both the distribution network and the transmission network;
- It enhances the new governance arrangements for economic regulation of Transmission services and the future economic regulation of Distribution services by ensuring that economic

[6] Expert Panel on Energy Access Pricing Report to the Ministerial Council on Energy, p10
[7] ibid p11,12
[8] Standing Committee of Officials of the Ministerial Council on Energy "2006 Comprehensive Legislative Package: Overview and response to Expert panel on Energy Access Pricing", November 2006 p10.
[9] AEMC Rule Determination: National Electricity Amendment (Economic Regulation of Transmission Services) Rule, November 2006 pxiii

regulation is based on the service provided and not on the asset that contributes to the service;

- For EnergyAustralia (and DNSPs in a similar position) and for the AER it would dramatically reduce the regulatory obligations associated with two regimes for effectively similar assets, with minimal (if any) impact on customers.
- For many other DNSPs it clarifies in the Rules current regulatory practice and would have minimal impact on customers;
- It promotes the characteristics of the Chapter 6A Rules by ensuring that the AER is provided guidance in its decision-making for this Clause. It also clarifies existing ambiguity about the delineation between distribution and transmission services and regulation; and
- It overcomes the classification of the regulatory framework based on a technical definition of the asset and focuses more on the service provided, particularly where the same asset may be operating in the distribution system and transmission system at different times.

5.1 Market Impacts

EnergyAustralia engaged PB Associates to undertake an independent review of the impact of EnergyAustralia's proposal on both transmission and distribution customer prices. They conclude that apart from process efficiencies gained by streamlining regulatory processes, there are no significant impacts on customer prices or EnergyAustralia revenues except for the following:

- The extent to which the regulatory process for distribution will yield different outcomes to those of transmission – for example PB noted that traditionally higher WACC parameters for distribution (based on a different risk profile) could yield higher returns if assets shift between transmission and distribution. PB notes that these gains are at the margin and need to be tempered against other regulatory factors (for EnergyAustralia, a theoretical favourable movement of $380,000 pa for improved returns from a higher WACC needs to be measured against unfavourable outcomes in incentive payments for service standards – approx $500,000 pa.)
- The extent to which the allocation of revenues is based on an overall asset allocation or a more detailed allocation by each building block component. EnergyAustralia has accepted PB's recommendation to continue to allocate revenues at the building block component level.
- The extent to which a single regulatory process mandates a single pricing methodology. We explain our response to the need for continuance of transmission pricing arrangements (under certain conditions) in the next section below.

5.2 Why the NEM Objective requires a separate treatment of allocation for pricing purposes

EnergyAustralia believes that it has sufficiently justified its proposed Rule change on the basis that it will address the problem of undertaking two regulatory review processes for essentially the same set of assets. The benefit from the reduced inefficiencies between the DNSP and the AER promotes good regulatory practice and ensures the regulatory process is as transparent as practicable.

However, the NEM Objective is not promoted or achieved if the benefits from addressing the problem are outweighed by the consequential effect of the solution proposed. For example, if a solution to problem improves transparent regulatory practice but consequentially affects the stability and predictability of long term investment decisions, the NEM Objective may not be satisfied.

EnergyAustralia has therefore sought a solution that ensures customer impacts are mitigated by requiring the AER to allow for separate pricing frameworks for transmission assets, even if they have been subject to a single regulatory process for the determination of revenues. In EnergyAustralia's case this would ensure that existing long term investment decisions are preserved.

The Commission's approach to this issue is quite clear in other decisions:

> *…the NEM Objective is not solely focussed on a technical approach to the promotion of efficiency. Rather, the NEM Objective has implications for the means by which regulatory arrangements operate as well as their intended ends. This means that … other things being equal, transmission prices should be sufficiently stable and predictable to enable participants to plan and make long term decisions without suffering price shocks.*[10]
>
> *Rather than seeing distributional outcomes as a distinct limb or component of the NEM Objective, the Commission has taken the view that distributional outcomes have relevance in so far as they may negatively influence the stability and integrity of the pricing arrangements. Therefore, the Commission proposes to maintain or adopt measures that limit the extent of price shocks for transmission network users*[11]
>
> *Rule changes should not only offer demonstrated efficiency benefits to promote the NEM Objective, but should minimise the scope for operational intervention in the market, avoid short-term changes that are not robustly beneficial over time and Rule changes should not only offer demonstrated efficiency benefits to promote the NEM Objective, but should minimise the scope for operational intervention in the market, avoid short-term changes that are not robustly beneficial over time and improve the transparency of market operation.*[12]

We believe that proposed changes which allow the AER discretion to subject revenues earned on transmission assets to be subject to separate pricing arrangements ensure stability in the market by minimising any potential price shocks to customers.

5.3 Assessment against other options – status quo

Not proceeding with this Rule change will have minimal impact on the market, the technical operation of the market and customer prices. However, the current arrangement will subject EnergyAustralia and the AER to separate regulatory processes for different parts of the same network. There are no benefits from this approach as much of the regulatory assessment reverts to the prudency of the allocation of the costs rather than the prudency of the investment itself.

The regulatory imposts are high considering a large part of the revenue preparation, submission and assessment is redundant between the two regimes.

As noted above, it is likely that in the future many other DNSPs will be subject to a similar fate. There is an increased likelihood of assets over 66kV built for the purpose of supporting the distribution network being classified as part of the Transmission network because they support the higher voltage transmission network. This means that more DNSPs will be subject to dual regulatory processes for the same network, or the AER will enter into informal arrangements for distribution

[10] AEMC Rule Determination for National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 p10
[11] AEMC Rule Determination for National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 p10
[12] AEMC Draft Rule Determination - Abolition of Snowy region p65

networks who own a very small proportion of transmission networks – neither of which is likely to promote efficiency and transparency

Compared to the proposed Rule change, the status quo approach does not promote the NEM Objective.

5.4 Assessment against other options – derogation

A derogation (similar to that provided for Queensland businesses) would achieve the primary purpose of this Rule change. However it would dramatically change the existing pricing arrangements EnergyAustralia has with some of its larger customers.

While these changes would represent a wealth transfer either between networks or across classes of customers, any change to the status quo is likely to draw unfavourable response. Large customers are very price conscious and can be expected to react strongly if a change to the cost allocation increases their price.

Changing the existing pricing framework would also have an impact on existing metering and market arrangements. The establishment of transmission metering to connection points within the EnergyAustralia network is a major project which is now close to completion, with the Sydney and Central Coast areas slated for transfer into the market by the end of 2006. To facilitate this transfer, EnergyAustralia was successful in obtaining a derogation from the Rules in June 2006 to transfer metering installations where the primary equipment (Current and Voltage Transformers) does not comply with the testing requirements in the Rules.

Should EnergyAustralia now seek to classify all its network assets as distribution, it would follow that market settlements would revert to the former TransGrid Bulk Supply Points and transmission and distribution loss factors be recalculated accordingly. This is likely to be seen by Regulators as a retrograde step in the provision of cost reflective price signals to market participants and therefore would run contrary the NEM Objective.

Compared to the proposed Rule, a derogation that does not provide consequential treatment of pricing implications does not promote the NEM Objective.

5.5 Assessment against other options – derogation which allows for pricing implications

This approach was seriously considered by EnergyAustralia. However, the problem identified is not peculiar to EnergyAustralia. A derogation would address EnergyAustralia's issues but would leave open any implications for other DNSPs in a similar predicament.

Compared to the proposed Rule, a derogation specific to EnergyAustralia would not promote the NEM Objective. This option would only be considered as a short term measure (if for example the Rule change could not be expedited due to wider market implications).

6 Request for Expedition of the Proposed Rule

6.1 Why the proposed Rule is urgent

EnergyAustralia began preparing for its 2009-14 network revenue determinations in November last year. We are currently preparing the inputs, assumptions, modelling and documentation that will support our forecast expenditure. Under normal conditions we would begin preparing our revenue proposal around 6 months prior to lodgement. However, our regulatory arrangements for distribution are yet to be finalised, and it is likely that we will need to submit information on our distribution revenue determination in this calendar year.

Our timetables are therefore extremely tight, particularly given the uncertainty surrounding the Rules for our next determination. An expedited decision is essential to allow appropriate time for:

- EnergyAustralia to make an application to the AER under the proposed clause 6A.1.4, say within one month of determination;
- the AER to consider , consult on and determine the application- 3 months; and
- EnergyAustralia to meet its regulatory obligations in respect of its distribution revenue proposal and prepare a revenue proposal for submission.

This demonstrates that if the rule is not expedited, it would not be possible for this issue to be addressed in an appropriate time for EnergyAustralia to apply it to the next regulatory control period.

Section 36B of the Draft National Electricity Law (NEL), if enacted, would prohibit the AEMC from making a Rule relating to revenue earned or prices charged in respect of a distribution network. This Section places further pressure on the need for a Rule to be made before the NEL is enacted. Otherwise, there is a strong risk that the AEMC would be required to "stop the clock" between the time the NEL amendments become Law and the new Rules for distribution come into effect.

6.2 Why the proposed rule is not controversial

The Rule change is non-controversial as it will have no significant market implications and is unlikely to result in any material change from the status quo. There would be no change to the way EnergyAustralia operates its assets, no change in network boundary or the technical operation of either network.

The only immediate change would be that EnergyAustralia (if it elected to make a single regulation determination application) would be subject to a single economic regulatory regime for its network assets, hence avoiding the unnecessary duplication of undertaking two separate regulatory processes. EnergyAustralia has proposed that the AER have further discretion to apply the transmission pricing regime be included in the Rule so as to avoid any adverse impacts on customers and market arrangements.

In addition the Rule would only impact DNSPs who elect to apply the Clause and subject to AER approval. We believe this provides a sufficient balance between flexibility and consistency for different market participants.

Conversely, not addressing this issue is likely to have far reaching implications for DNSPs. Clearer delineation of prescribed services for transmission and distribution will result in a stricter interpretation of what falls into different service categories. It is likely that in the absence of change other DNSPs within the NEM would be subject to two different regulatory regimes. The regulatory impost is significant given that, in some instances, the DNSP may own only one or two Transmission assets.

Appendix 1: Suggested drafting

Item 1 Amendment to clause 6A.1.4

After rule 6A.1.4(b) insert:

(c) A DNSP who owns, operates or controls parts of a transmission network operating at nominal voltages between 66 kV and 220kV that operate in parallel to and provide support to the higher voltage transmission network may apply to the AER for those parts of the network to be made subject to the regulatory arrangements for the distribution service pricing set out Chapter 6.

(d) Schedule 6.4A applies to an application made under clause 6A.1.4(c).

Item 2 New Schedule 6A.4

Schedule 6A.4 - Regulatory Arrangements for Transmission Services incidental to the provision of distribution services.

S6A .4.1 Application of Schedule

(a) This Schedule applies to the determination of applications under clause 6A.1.4(c) and sets out the regulatory arrangements to apply following the approval of an application.

(b) In this Schedule:

(1) a *single revenue determination application* means an application under clause 6A.1.4(c).

(2) *dual function assets* means those parts of a transmission network the subject of an application under clause 6A.1.4(c).

(3) *approved dual function assets* means dual function assets the subject of a *single revenue determination application* which has been approved or deemed to have been approved by the AER under this Schedule 6A.4.

S6A.4.2 Requirements in relation to a single revenue determination

A *single revenue determination application* must:

(a) not be made:

(1) In the case of an application in respect of *dual functions assets* the subject of a *transmission determination*, less than 16 months before the expiry of the *regulatory control period* applicable to the *transmission determination* in force at the time the application is made, unless the AER approves a shorter period;

(2) In the case of an application in respect of *dual function assets* the subject of a determination under Chapter 6, less than 16 months before the expiry of the regulatory control period applicable to the Distribution Network Service Provider's distribution system at the time the application is made, unless the AER approves a shorter period.

(3) In the case of any other application, less than 3 months before the commencement of the next regulatory control period applicable to the Distribution Network Service Providers distribution system, unless the AER approves a shorter period.

(b) comply with any guidelines made by the AER under clause 6A.4.6; and

(c) contain sufficient information to enable the to enable the AER determine:

(1) whether to approve the application; and

(2) the appropriate pricing arrangements to apply to the services provided by approved *dual function assets*.

(d) As soon as practicable after its receipt of a *single revenue determination application*, the AER must publish the application, together with an invitation for written submissions on the application and allow a period of not more than 20 business days for the making of any submissions.

(e) The AER must consider any written submission made under paragraph (d) and must make its decision on the application within 60 business days of its receipt of the application.

(f) If the AER is satisfied of the matters referred to in clause S6A.4.3 it must determine:

(1) to approve the application; and

(2) whether the pricing arrangements in clause S6A.4.7 should apply to the *dual function assets*.

S6A.4.3 Circumstances in which an application must be approved.

The AER must approve a *single revenue determination application* if it is satisfied that:

(a) the *transmission services* provided by the *dual function assets* are provided as a consequence of or incidental to the provision of *distribution services*;

(b) there is no evidence that there will be a material impact on the operation of the national electricity market as a result of the application being approved; and

(c) There is no evidence that there will be any material implications for the technical operation of the transmission system or the distribution system as a result of the application being approved.

For the purposes of this clause S6A.4.3, the *transmission services* provided by the *dual function assets* are provided as a consequence of or incidental to the provision of *distribution services* if the *dual function assets* were constructed to operate as part of the Distribution Network Service Provider's *distribution network* but operate in support of both the *distribution network* and the higher voltage *transmission network*.

S6A.4.5 Circumstances in which an application will be deemed to be approved

(a) The AER will be deemed to have approved a *single revenue determination application* if it has not determined to approve or refuse the application within 60 business days of the application being made.

(b) If a *single revenue determination application* is deemed to be approved under sub-clause (a), the AER must make a determination referred to in S6A.4.2(f)(2) within 20 business days of the deemed approval.

S6A4.6 Regulatory Arrangements which apply to *approved dual function* assets.

(a) From the commencement of the *regulatory control period* which applies to the Distribution Network Service Provider's distribution system immediately following an approval under this Schedule 6A.4, *approved dual function assets* will be the subject of economic regulation under Chapter 6 and will not be subject to Chapter 6A except to the extent determined by the AER in accordance with clause 6A.4.7.

(b) If the *regulatory control period* which applies to the Distribution Network Service Provider with respect to its distribution network is not the same as the *regulatory control period* that applies with respect to its transmission network, the AER must determine the appropriate adjustments (if any) to be made to the relevant determination to ensure the appropriate transition of *approved dual function assets* from economic regulation under Chapter 6A to economic regulation under Chapter 6.

(c) The AER may, as part of the Cost Allocation Guidelines prepared under clause 6A.19.3, include guidelines on the cost allocation methodology to be applied by a DNSP making a *single revenue determination application*.

S6A.4.7 Determination that alternative pricing arrangement to apply to *approved dual function assets*

(a) The AER may determine that the one or all of the alternative pricing arrangements specified in sub-clause (b) will apply to *approved dual function assets* if it is satisfied that:

(1) the revenues to be earned in respect of the dual function assets are significant enough to justify a separate pricing method;

(2) there are no material regulatory or market impediments to the application the alternative pricing arrangements; and

(3) Customers would not be materially adversely affected by the application of the alternative pricing arrangements.

(b) The alternative pricing arrangements which may be determined by the AER to apply to *approved dual function assets* are

(1) the application of Part J of Chapter 6A.

(2) the preparation of a *negotiating framework* to apply to the negotiated transmission services provided by the *approved dual function assets* under clause 6A.9 and the application of Part D of Chapter 6A to those services.

(c) Where the AER determines that the alternative pricing arrangement in sub-clause (b)(1) are to apply to *approved dual function assets*, the following provisions will apply to enable the application of Part J of Chapter 6A:

(1) When the AER makes a determination in relation to the economic regulation of the Distribution Network Service Provider's *prescribed distribution services*, it must also determine the Annual Building Block Revenue Requirement and the Maximum Allowed Revenue in respect of the prescribed transmission services provided by the *dual function assets* for each year of the *regulatory control period*.

(2) The Annual Building Block Revenue Requirement referred to in sub-clause (c)(1) must be determined by allocating a proportion of the revenue requirement determined for all services the subject of the revenue determination (other than those solely attributable to services other than prescribed transmission services) to each building block component attributable to the revenue associated with *approved dual function assets* on a basis which is consistent with the cost allocation principles in Clause 6A.19.2.

(3) The Maximum Allowed Revenue referred to in sub-clause (c)(1) must be determined, by taking the Annual Building Block Revenue Requirement determined under sub-clause (c)(2) and applying:

(i) a methodology which the AER determines is likely to result in the best estimates of expected inflation consistent with clause 6A.5.3(b)(1);

(ii) a CPI –X methodology to escalate the maximum allowed revenue for each year (other than the first year) of the regulatory control period which is consistent with clause 6A.5.3(b)(5); and

(iii) an "X" factor that is consistent with clause 6A.6.8.

(4) For the purposes of clause 6A.22.1, the aggregate annual revenue requirement is the maximum allowed revenue determined under sub-clause (c)(3).

(5) Where an adjustment is made to allowed revenues during a regulatory control period, the Annual Building Block Revenue Requirement must be adjusted by allocating the adjusted revenue requirement in the same manner described in sub-clause (2).

(d) Where the AER determines that the alternative pricing arrangements in sub-clause (b)(2) are to apply to approved dual function assets, Part D of Chapter 6A applies to those services and the DNSP must prepare a negotiating framework to apply to the negotiated transmission services which complies with clause 6A.9.5.

Item 3 Consequential Changes to other parts of the Rules

Omit clause S6A.2.1 (f) (8) and substitute:

(8) Without prejudice to the application of any other provision of this paragraph (f), the previous value of the regulatory asset base may be increased by the inclusion of:

(i) **the value of** past capital expenditure that has not been included in that value because that capital expenditure was incurred in connection with the provision of services that are not *prescribed transmission services*, and in these circumstances, such capital expenditure must only be included to the extent the asset in respect of which that capital expenditure was incurred is subsequently used for the provision of *prescribed transmission services*; and

(ii) **the value of** past capital expenditure that has not been included in that value, but only to the extent that such past capital expenditure:

(A) relates to an asset that is used for the provision of *prescribed transmission services*;

(B) is considered by the *AER* to be reasonably required in order to achieve one or more of the *capital expenditure objectives*;

(C) is properly allocated to *prescribed transmission services* in accordance with the principles and policies set out in the *Cost Allocation Methodology* for the relevant *Transmission Network Service Provider*; and

(D) has not otherwise been recovered.