



Australian Energy Market Commission

DRAFT RULE DETERMINATION

National Electricity Amendment (Payments under Feed-in Schemes and Climate Change Funds) Rule 2010

Rule Proponent

ETSA Utilities

Commissioners

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8 April 2010

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For and on behalf of the Australian Energy Market Commission

RULE
CHANGE

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About the AEMC

The Council of Australian Governments, through its Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005 to be the rule maker for national energy markets. The AEMC is currently responsible for rules and providing advice to the MCE on matters relevant to the national energy markets. We are an independent, national body. Our key responsibilities are to consider rule change proposals, conduct energy market reviews and provide policy advice to the Ministerial Council as requested, or on AEMC initiative.

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Summary of draft Rule determination

On 7 October 2009, ETSA Utilities made a request to the Australian Energy Market Commission (AEMC or Commission) to make a Rule regarding the way in which distribution network service providers (DNSPs) may recover payments they make under feed-in tariff schemes and climate change funds.

A number of jurisdictions currently have in place feed-in schemes where payments are made (or credits given) by DNSPs to certain parties, such as to owners of distributed renewable generation installations, for electricity distributed generation installations generate or "feed back" into the distribution network. New South Wales also has in place a Climate Change Fund, which is a government fund that may be used provide funding to assist with various environmental initiatives or to fund contributions by NSW for the purpose of national energy regulation.

Currently there is no explicit mechanism under the National Electricity Rules (NER or Rules) for DNSPs to recover payments they make under these schemes. ETSA Utilities proposed that provisions be added to Chapter 6 of the Rules to create a new cost recovery mechanism for the recovery of these payments.¹

Commission's draft Rule determination

Under section 99 of the National Electricity Law (NEL), the Commission has determined it should not make the Rule proposed by ETSA Utilities and to make a more preferable Rule, being the draft National Electricity Amendment (Payments under Feed-in Schemes and Climate Change Funds) Rule 2010 (Draft Rule). The Draft Rule maintains the intent of the Rule proposed by ETSA Utilities, and it proposes a new cost recovery mechanism to allow DNSPs to recover payments made under jurisdictional schemes, which include feed-in schemes and climate change funds, under the pricing provisions in Chapter 6 of the Rules. The Draft Rule also includes specific transitional provisions to allow DNSPs to utilise the new cost recovery mechanism in their current regulatory control periods.

The Commission is satisfied the Draft Rule meets the Rule making test under section 88 of the NEL and will, or is likely to, better contribute to the achievement of the National Electricity Objective (NEO) than the Rule proposed in the Rule change request. In making this assessment, the impacts of the Draft Rule on promoting the efficient operation of electricity services were taken into account.

Making a submission or request for a hearing

The Commission invites written submissions on this draft Rule determination, including the Draft Rule, by 21 May 2010.

¹ It is noted that there are provisions under the transitional Chapter 6 provisions in Chapter 11 of the Rules to allow NSW DNSPs to recover payments made to the NSW Climate Change Fund.

In accordance with section 101(1a) of the NEL, any interested person or body may request that the Commission hold a hearing in relation to the draft Rule determination. Any request for a hearing must be made in writing and must be received by the Commission no later than 15 April 2010.

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1 ETSA Utilities' Rule change request

1.1 The Rule change request

On 7 October 2009, ETSA Utilities (Rule Proponent) made a request to the Australian Energy Market Commission (AEMC or Commission) to make a Rule regarding the way in which distribution network service providers (DNSPs) may recover payments they make under feed-in tariff schemes and climate change funds (Rule Change Request). The Rule Change Request included proposed amendments to Chapter 6 of the National Electricity Rules (NER or Rules).

1.2 Rule change request rationale

A number of jurisdictions have introduced feed-in schemes where payments are made (or credits given) to eligible parties, such as owners of distributed renewable generation installations, for the electricity distributed generation installations generate or "feed back" into the distribution network. New South Wales (NSW) also has in place a Climate Change Fund, which is a fund that can be used to provide funding to assist with various environmental initiatives or to fund contributions by NSW for the purpose of national energy regulation.

Although the details of the feed-in schemes and the climate change funds vary, these schemes require DNSPs to make payments or give credits to eligible parties. The Rule Change Request stated that "DNSPs are both the ultimate vehicle through which payments are made to customers for the gross or net energy they produce or to the fund for climate change abatement initiatives and, by levying incremental charges, the means by which these payments can be recovered from the general population of customers".²

Currently there is no explicit mechanism under the Rules for DNSPs to recover payments they make (or, in the case of credits being provided, revenue foregone) under feed-in schemes and climate change funds.³ To date, the recovery of the payments made under feed-in schemes has been addressed through DNSPs forecasting the payments as a component of operating expenditure in their regulatory proposals. Subject to a materiality threshold, any over/under recovery of the payments would be adjusted under the provisions for a pass through event.⁴ The proposed Rule change

² ETSA Utilities' Rule Change Request, p. 1.

³ It is noted that a Climate Change Fund is in place in NSW and provisions under the transitional Chapter 6 of the Rules provide a mechanism for the recovery of contributions made to this fund by DNSPs in the 2009-2014 regulatory control period. Specific requirements for NSW with respect to this Rule Change Request is discussed further in chapter 8 of this determination.

⁴ That is, the pass through provisions under clause 6.6.1 of the Rules would be used. This process has been adopted in the 2009-2010 to 2013-2014 distribution determination for ActewAGL for the recovery of payments that ActewAGL makes under the ACT feed-in scheme. The draft distribution determination for ETSA Utilities, Ergon and Energex has adopted similar provisions for the next regulatory control period for these DNSPs.

would introduce an explicit mechanism for the recovery of the payments under feed-in schemes and climate change funds under the pricing provisions in Chapter 6 of the Rules.

1.3 Solution proposed by the Rule Change Request

In the Rule Change Request the Rule Proponent seeks to add an explicit provision in the Rules to allow DNSPs to recover payments they make under feed-in schemes and climate change funds. The Rule Change Request proposed to:

- add provisions to Chapter 6 of the Rules to set out a new mechanism for the recovery of payments under feed-in schemes and climate change funds under the pricing provisions (outside of the distribution determination process). This new mechanism would provide that a DNSP's pricing proposal would set out the recovery of tariffs designed to be passed on to customers and adjustments of any over/under recovery from the previous regulatory year; and
- make consequential amendments to a number of other clauses in Chapter 6 and Chapter 10 of the Rules.

1.4 Commencement of Rule making process

On 14 January 2010, the Commission published a notice under section 95 of the National Electricity Law (NEL) advising of its intention to commence the Rule change process and the first round of consultation in respect of the Rule Change Request. A consultation paper prepared by AEMC staff identifying specific issues or questions for consultation was also published with the Rule Change Request. Submissions closed on 12 February 2010.

The Commission received nine submissions on the Rule Change Request as part of the first round of consultation. The submissions are available on the AEMC website.⁵ A summary of the issues raised in submissions and the Commission's response to each issue is contained in Appendix A.

The Rule Proponent had requested that the Commission consider expediting the Rule Change Request on the basis that the Rule Change Request was non-controversial as it would not impact other market participants.⁶ In addition, the Rule Proponent noted that it had consulted with DNSPs in other jurisdictions, the South Australian Government and the Australian Energy Regulator (AER) in preparing the Rule Change Request.⁷

⁵ www.aemc.gov.au

⁶ Under section 96 of the NEL, if the AEMC considers that a request for a Rule is a request for a non-controversial Rule or for an urgent Rule, the AEMC may expedite the Rule Change Request process such that the final Rule determination in respect of the relevant Rule must be published 6 weeks from the date of the publication of the notice under section 95 of the NEL.

⁷ ETSA Utilities' Rule Change Request, p. 2.

The Commission considered that the Rule Change Request was not a request for a non-controversial Rule and therefore decided not to expedite the Rule Change Request under section 96 of the NEL.

1.5 Consultation on draft Rule determination

In accordance with the notice published under section 99 of the NEL, the Commission invites submissions on this draft Rule determination, including the draft Rule, by 21 May 2010.

In accordance with section 101(1a) of the NEL, any person or body may request that the Commission hold a hearing in relation to the draft Rule determination. Any request for a hearing must be made in writing and must be received by the Commission no later than 15 April 2010.

Submissions and requests for a hearing should quote project number ERC0097 and may be lodged online at www.aemc.gov.au or by mail to:

Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

2 Draft Rule Determination

2.1 Commission's draft determination

In accordance with section 99 of the NEL, the Commission has made this draft Rule determination in relation to the Rule proposed by ETSA Utilities.

The Commission has determined that it should not make the Rule proposed by the Rule Proponent and it should make a proposed more preferable Rule.⁸

The Commission's reasons for making this draft Rule determination are set out in section 3.1

A draft of the proposed Rule to be Made (Draft Rule) is attached to and published with this draft Rule determination. The Draft Rule is different from the Rule proposed by the Rule Proponent. Its key features are described in section 3.2.

2.2 Commission's considerations

In assessing the Rule Change Request the Commission has considered the following matters:

- the Commission's powers under the NEL to make the Rule;
- the Rule Change Request;
- the fact that there is no relevant Ministerial Council on Energy (MCE) Statement of Policy Principles in relation to this Rule Change Request;⁹
- submissions received during first round consultation; and
- the Commission's analysis as to the ways in which the proposed Rule will or is likely to, contribute to the National Electricity Objective (NEO).

2.3 Commission's power to make the Rule

The Commission is satisfied that the Draft Rule falls within the subject matter about which the Commission may make Rules. The Draft Rule falls within section 34(2) of the NEL which states that "...[the AEMC] may make Rules for or with respect to any matter or thing specified in Schedule 1" of the NEL. The Draft Rule falls within the matters set

⁸ Under section 91A of the NEL the AEMC may make a Rule that is different (including materially different) from a market initiated proposed Rule (a more preferable Rule) if the AEMC is satisfied that having regard to the issue or issues that were raised by the market initiated proposed Rule (to which the more preferable Rule relates), the more preferable Rule will or is likely to better contribute to the achievement of the NEO.

⁹ Under section 33 of the NEL the AEMC must have regard to any relevant MCE Statement of Policy Principles in making a Rule.

out in Schedule 1 to the NEL as it relates to the regulation of prices that are charged by DNSPs in their provision of distribution services.¹⁰ That is, item 26 of Schedule 1 of the NEL states:

“The regulation of prices (including the tariffs and classes of tariffs) charged or that may be charged by owners, controllers or operators of distribution systems for the provision by them of services that are the subject of a distribution determination.”

2.4 Rule making test

Under section 88(1) of the NEL the Commission may only make a Rule if it is satisfied that the Rule will, or is likely to, contribute to the achievement of the NEO. This is the decision making framework that the Commission must apply.

The NEO is set out in section 7 of the NEL as follows:

“The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- (a) price, quality, safety, reliability and security of supply of electricity;
and
- (b) the reliability, safety and security of the national electricity system.”

For the Rule Change Request, having regard to any relevant MCE Statement of Policy Principles, the Commission considers that the relevant aspect of the NEO is promoting the efficient operation of electricity services.¹¹

The Commission is satisfied that the Draft Rule will, or is likely to, contribute to the achievement of the NEO because the Draft Rule promotes administrative efficiency and productive efficiency in the operation of electricity services. It also promotes the efficiency by which DNSPs carry out forecasts. Efficiency in the operation of electricity services would minimise the costs faced by DNSPs and the regulator, and hence should be in the long term interest of consumers with respect to price of supply of electricity. The Draft Rule promotes efficiency in the following ways:

- Administrative efficiency - the Draft Rule contributes to administrative efficiency by providing a specific mechanism under the pricing provisions for the recovery of payments made by DNSPs under jurisdictional schemes. This new mechanism removes the requirement for the recovery of these payments to be addressed under the distribution determination and pass through processes, which reduces

¹⁰ Some clauses in the Draft Rule also fall within matters set out in item 25 or item 26H of Schedule 1 to the NEL.

¹¹ Under section 88(2) of the NEL, for the purposes of section 88(1) the AEMC may give such weight to any aspect of the NEO as it considers appropriate in all the circumstances, having regard to any relevant MCE statement of policy principles.

the administrative burden faced by DNSPs and the Australian Energy Regulator (AER);

- Productive efficiency - the Draft Rule contributes to productive efficiency as it provides for payments made under any future eligible jurisdictional schemes to be recovered through the new cost recovery mechanism. This contributes to productive efficiency as, if the new mechanism did not apply to new schemes, DNSPs would be required to seek recovery under a pass through event which would likely require more resources from DNSPs and the AER to undertake applications and assessments; and
- Efficiency and accuracy of payment forecasts - the Draft Rule contributes to the efficiency by which DNSPs produce forecasts of payments that need to be made as the new cost recovery mechanism in the Draft Rule provides for annual adjustments for over/under recovery to be carried out more efficiently under the pricing process as opposed to a cost pass through process. In addition, the Draft Rule would require DNSPs to produce annual estimates of costs which would likely be more accurate than the five-year forecasts currently required. This improves the ability for DNSPs to recover any costs closer to the time they were actually incurred and increase the likelihood that costs are recovered from the customer base in relation to whom the costs were incurred.

Under section 91(8) of the NEL the Commission may only make a Rule that has effect with respect to an adoptive jurisdiction if it is satisfied that the proposed Rule is compatible with the proper performance of the Australian Energy Market Operator's (AEMO's) declared network functions. The Draft Rule is compatible with AEMO's declared network functions because it has no impact on Rules relating to AEMO's declared network functions nor transmission network service providers in general.

2.5 More preferable Rule

Under section 91A of the NEL, the AEMC may make a Rule that is different (including materially different) from a market initiated proposed Rule (a more preferable Rule) if the AEMC is satisfied that, having regard to the issue or issues that were raised by the market initiated proposed Rule (to which the more preferable Rule relates), the more preferable Rule will or is likely to better contribute to the achievement of the NEO.

Having regard to the issues raised by the Rule proposed in the Rule Change Request, the Commission is satisfied that the Draft Rule will, or is likely to, better contribute to the NEO for the following reasons:

- Clear transitional provisions - the Draft Rule sets out specific transitional provisions to allow the new cost recovery mechanism to be adopted in a timely manner, which would allow the potential efficiency gains to be realised sooner;
- Specific transitional provisions for NSW - the Draft Rule sets out specific transitional provisions for NSW and clarifies the existing provisions under the

transitional Chapter 6, which ensures the potential efficiency gains under the Draft Rule would be available to all DNSPs equally;

- Applicable schemes - the Draft Rule more clearly sets out the applicable schemes and provides a criteria for which any future schemes would be required to meet, which provides transparency and ensures that DNSPs could utilise the new cost recovery mechanism for any eligible new schemes.

2.6 Other requirements under the NEL

Under section 88B of the NEL, the AEMC must take into account the revenue and pricing principles in making a Rule for, or with respect to, any matter or thing specified in items 15 to 24 and 25 to 26J of Schedule 1 of the NEL. The Commission has taken into account the revenue and pricing principles in making this draft Rule determination as the Rule relates to item 26 of Schedule 1 of the NEL. Some aspects of the revenue and pricing principles relate to providing a reasonable opportunity to service providers to recover efficient costs and ensuring that prices should allow for a return commensurate with the regulatory and commercial risks in providing the service. The Commission considers that the Draft Rule is consistent with the revenue and pricing principles as it provides an efficient and transparent mechanism for the recovery of payments that DNSPs, in their capacity as DNSPs, are obligated to make under legislation.

3 Commission's reasons

The Commission has analysed the Rule Change Request and assessed the issues/propositions arising out of this Rule Change Request. For the reasons set out below, the Commission has determined that a more preferable Rule should be made.

3.1 Assessment

The Commission considers that DNSPs should be provided with reasonable opportunity to recover any payments mandated by legislation where no other recovery mechanism is applicable outside the Rules.¹² The feed-in schemes and the NSW Climate Change Fund currently in place impose obligations on DNSPs to make payments (or apply credits) to certain parties or into a government fund. As these obligations are imposed on the DNSPs in their capacity as DNSPs, the DNSPs should be provided with an opportunity to recover these payments under the Rules as part of their costs of providing distribution network services.

Currently, there are no explicit mechanisms under the Rules for the recovery of these types of payments.¹³ Recovery of payments made under feed-in schemes have, to date, been addressed as operating expenditure through the distribution determination process with the pass through mechanism used to adjust any over/under recovery. However, the distribution determination process and the pass through mechanism were not designed to address the recovery of payments made by DNSPs under jurisdictional schemes such as feed-in schemes. To provide a solution to address the problems under the current approach for the recovery of these payments, a Rule would be required to introduce a more appropriate cost recovery mechanism for the recovery of payments that DNSPs are required to make, in their capacity as DNSPs, under legislation where:

- there are no means of recovering the payments;¹⁴
- the payment amounts are specified or determined in accordance with legislation.

3.2 Draft Rule

The Draft Rule provides a new cost recovery mechanism for the recovery of payments made (or revenue foregone in the case of credits applied) by DNSPs under jurisdictional schemes (such as feed-in schemes and climate change funds). The Draft Rule sets out:

¹² The Commission notes that the ability to recover the payments would not apply to any payments in the nature of fines, penalties or incentives.

¹³ It is noted that the transitional Chapter 6 that applies to NSW and the ACT for the 2009-2014 regulatory control period includes provisions for the recovery of payments made to the NSW Climate Change Fund.

¹⁴ As noted above, the recovery would exclude payments in the nature of fines, penalties or incentives.

- a new cost recovery mechanism under the pricing process, which includes a provision to allow any over/under recovery during the previous regulatory year to be adjusted:
 - a DNSP would be required to outline its forecast recovery amounts for each relevant scheme under its annual pricing proposal;
 - any adjustment for over/under recovery from the previous regulatory year would be allowed. This would include the ability to adjust for any over/under recovery in the last year of a regulatory control period in the first year of the next regulatory control period;
- a requirement under the distribution determination process for the DNSP to set out, for the AER's approval, how it would report on its recovery under the new cost recovery mechanism:
 - the AER would make a decision in the distribution determination process on how a DNSP is to report to the AER on its recovery of the payments under the relevant jurisdictional schemes;
- that payments made (or credits given) under current applicable schemes and any new schemes, which meet the defined criteria, may be recovered using this mechanism:
 - if a new scheme that meets the relevant eligibility criteria were to be introduced part way through a regulatory control period, a DNSP would be able to include the recovery for any relevant payments under the new scheme in the next pricing proposal subject to meeting relevant reporting requirements;
- transitional provisions to enable the Draft Rule to be applied during the current regulatory control period:
 - a DNSP would have the option as to whether or not to adopt the new cost recovery mechanism in the current regulatory control period;
 - if a DNSP elected to opt in to the new cost recovery mechanism, it would need to make an election to the AER and an application to the AER requesting a revocation and substitution of its distribution determination (where applicable) and setting out how the DNSP would report to the AER on its recovery of the payments under the pricing proposal process;
 - amendments have also been made to transitional Chapter 6 of the Rules that applies to NSW and ACT for the 2009-2014 regulatory control period to provide the option for the DNSPs in NSW and ACT to adopt the new mechanism in the current regulatory control period; and

- amendments have also been made to the provisions to allow adjustments for over/under recovery for payments made by NSW DNSPs to the Climate Change Fund to be made through the pricing proposal process.

The Rule proposed by ETSA Utilities included amendments to the clauses related to billing. It was proposed that a new category of charges be added for the recovery of payments made under feed-in schemes or climate change funds, which would be separate from distribution use of system charges. The Draft Rule does not include such amendments. The Commission notes that the obligations to make payments under the jurisdictional schemes are imposed on a DNSP in its capacity as a DNSP. In addition, the DNSP does not provide separate services in exchange for the payments. For these reasons, the Commission considers the recovery of the payments may be charged as a part of the price for providing distribution services, which would be a component of the distribution use of system charge.

3.3 Civil Penalties

The Draft Rule does not amend any Rules that are currently classified as civil penalty provisions under the National Electricity (South Australia) Regulations. The Commission would not propose to recommend to the MCE that any of the proposed amendments in the Draft Rule be classified as civil penalty provisions as the Draft Rule relates to the DNSPs' cost recovery processes under Chapter 6 of the Rules. The nature of the provisions under Chapter 6 of the Rules provides incentives to ensure that DNSPs adhere to the requirements so that their costs may be efficiently recovered.

4 Commission's assessment approach

This chapter describes the Commission's approach to assessing the Rule Change Request in accordance with the requirements set out in the NEL (and explained in Chapter 2).

In assessing this Rule Change Request, the Commission has considered the following issues:

- Administrative efficiency - the treatment of the recovery of payments under feed-in schemes under the current processes;
- Allocation of risks - how are risks associated with forecasting errors taken into account; and
- Accommodating future schemes - whether the proposed Rule, if made, should accommodate feed-in schemes, climate change funds and other schemes that may be introduced in the future.

In its assessment of the Rule Change Request, the Commission has also considered whether transitional provisions would be required to allow DNSPs to transition effectively to the proposed new cost recovery mechanism.

The Commission has focussed on these issues because they relate to the objectives and principles of the regulatory framework under Chapter 6 of the Rules. These objectives and principles include:

- Achieving a balance between the interests of DNSPs and end-use customers;
- Providing transparent and timely regulatory processes; and
- Increasing regulatory certainty and reducing the administrative burden on DNSPs and the AER.

5 Administrative efficiency

This chapter sets out the Commission's considerations in relation to the efficiency of the treatment of the recovery of payments under feed-in schemes and climate change funds using the current provisions under the Rules.

5.1 Rule Proponent's view

The Rule Proponent submitted that the current treatment of the recovery of payments made by DNSPs under feed-in schemes and climate change funds in the distribution determination process was not efficient. In the Rule Change Request, it was noted that the amount of forecast feed-in tariff payments included in DNSPs' operating expenditure would have to be assessed for efficiency by the AER under the distribution determination process. The Rule Proponent considered this would be "a needless assessment as it is a regulatory obligation for DNSPs to pay out for electricity generated using eligible systems regardless of whether it does in fact reflect efficient costs".¹⁵

Similarly, the Rule Proponent argued that the use of the pass through mechanism under Chapter 6 of the Rules to adjust any over and under recovery would also be inefficient and present an administrative burden on DNSPs and the AER. The pass through mechanism involves an application and assessment process to ensure that only efficient costs would be allowed to be passed through to customers, which would not be applicable to these payment amounts which are set by legislation. For this reason, the Rule Proponent considered that the use of the pass through mechanism for these payments would result in "frequent and unnecessary assessment processes" by DNSPs and the AER.¹⁶

5.2 Stakeholders' views

Stakeholders agreed in principle with the Rule Proponent's views on the issue of administrative efficiency. It was considered that the current treatment of the recovery of payments made by DNSPs under feed-in schemes and climate change funds should be addressed under the pricing process rather than under the distribution determination process.

However, some stakeholders noted the importance of distinguishing between costs incurred by a DNSP in administering/operating the schemes, and any system costs, from the actual payment amounts. These stakeholders agreed that the costs for administering the scheme should be considered as operating expenditure under the distribution determination process. These stakeholders noted that these costs would be within the control of the DNSP and, hence, should be subject to efficiency considerations.

¹⁵ ETSA Utilities' Rule Change Request, p. 7.

¹⁶ *ibid*

Some DNSPs also queried how the pass through process would be applied in practice to enable any over/under recovery to be adjusted. These DNSPs noted that any pass through application would be subject to a materiality threshold and questioned whether this threshold should be applied in principle. In addition, as the pass through mechanism relates to pass through amounts in a regulatory control period, concerns were raised as to whether the pass through mechanism could effectively provide for the adjustment of any over/under recovery that occurs in the last year of a regulatory control period.¹⁷

Additional details of the issues raised by stakeholders are provided in Appendix A.

5.3 Commission's analysis

The Rule Change Request proposed to add a new cost recovery mechanism under the pricing process on the basis that the current treatment of the recovery of payments made under feed-in schemes was inefficient. The Commission has considered the application of the current Rule determination and pass through provisions in the assessment of this Rule Change Request.

5.3.1 Distribution determination process

In considering the issue raised of whether payments made by DNSPs under feed-in schemes and climate change funds should be considered as operating expenditure, the Commission considered the requirements for operating expenditure under the Rules. Clause 6.4.3 of the Rules sets out the applicable building blocks to be used in the distribution determination for DNSPs and one of these building blocks is forecast operating expenditure. The forecast operating expenditure is the forecast operating expenditure for a regulatory control period a DNSP considers is required to achieve the operating expenditure objectives, which are to:¹⁸

1. meet or manage the expected demand for standard control services over that period;
2. comply with all applicable regulatory obligations or requirements associated with the provision of standard control services;
3. maintain the quality, reliability and security of supply of standard control services; and

¹⁷ That is, for example, clause 6.6.1(c)(5) of the Rules provides that a DNSP's pass through application should set out "the amount of the positive pass through amount that the provider proposes should be passed through to Distribution Network Users in each regulatory year during the regulatory control period". Submissions queried whether the pass through process could be used to adjust for over/under recovery if the over/under recovery related to a regulatory year in the previous regulatory control period.

¹⁸ Clause 6.5.6(a) of the Rules.

4. maintain the reliability, safety and security of the distribution system through the supply of standard control services.

The Commission notes that any forecast operating expenditure included in a regulatory proposal would then need to be assessed by the AER. In its assessment of a regulatory proposal, the AER must be satisfied that the forecast operating expenditure reasonably reflects:¹⁹

1. the efficient costs of achieving the operating expenditure objectives;
2. the costs that a prudent operator in the circumstances of the relevant DNSP would require to achieve the operating expenditure objectives; and
3. a realistic expectation of the demand forecast and cost inputs required to achieve the operating expenditure objectives.

Although the costs incurred by DNSPs under feed-in schemes and climate change funds may, in some respects, fall within the requirements for operating expenditure under clause 6.5.6(a) of the Rules, the Commission agrees with the issue raised in submissions that a distinction is required between the operating and system costs that may be incurred by DNSPs in complying with the regulatory obligations, and the actual payments (or credits) that DNSPs are required to make to other parties under those obligations.

Amounts of monies that DNSPs are required to pay (or credits that DNSPs are required to apply) as specified by legislation are not operating expenditure within the control of DNSPs. While it would be prudent to assess operating expenditure within the control of DNSPs for efficiency, there appears to be no additional benefits for including the payment amounts under jurisdictional schemes such as feed-in schemes and climate change funds in the building block process.

For these reasons, the Commission considers that it would be appropriate to consider the recovery of the payment amounts (or the revenue foregone in applying credits) through the pricing process as this would contribute to administrative and productive efficiency by removing the requirement for DNSPs to include the payment amounts as forecasting operating expenditure in its regulatory proposal and, hence, removing the requirement for the AER to consider the payment amounts in its distribution determination process.

5.3.2 Pass through process

In considering whether the issue raised by the Rule Change Request about the use of the pass through mechanism to address over/under recovery of payments made by DNSPs under feed-in schemes, the Commission considered the current pass through provisions under the Rules.

¹⁹ Clause 6.5.6(c) of the Rules.

Consistent with the revenue and pricing principles, which include ensuring service providers are provided with a reasonable opportunity to recover efficient costs it incurs in providing standard control services, the revenue process under Chapter 6 of the Rules includes a pass through mechanism to provide a degree of protection against, and a mechanism to manage, uncertainties that are inherent in the market.²⁰ The pass through mechanism requires the AER to make a determination on any pass through application taking into account various factors including the efficiency of a DNSP's decisions and actions in relation to the pass through event.²¹ This ensures that the pass through mechanism would only be used for unexpected costs that would not otherwise be compensated in the DNSP's distribution determination. The pass through mechanism also contains other safe-guards, such as requiring the DNSP to provide appropriate evidence and allowing the AER to consult with other stakeholders, to ensure that only relevant and efficient costs would be passed through.²²

The Commission considers that each pass through event would typically relate to one specific change in circumstances that was unknown at the time of making a distribution determination. In the case of the adjustments for the recovery of payments under feed-in schemes, the adjustments would be "known events" that would be expected to occur more than once (and possibly at least once a year) in the regulatory control period. Each application would impose administrative requirements on the DNSP and the AER to undertake the pass through application and assessment.

Given the Commission's considerations in section 5.3.1 that the recovery of payments made by DNSPs under jurisdictional schemes, such as feed-in schemes and climate change funds, should be included in the pricing process, the adjustments of any over/under recovery should also be addressed under the pricing provisions. That is, adjustments should be able to be made on an annual basis by including the relevant changes in the DNSPs' annual pricing proposals. This would enhance administrative efficiency as the administrative requirements that would be imposed on DNSPs and the AER under the pass through mechanism would no longer be required for these adjustments.²³

5.4 Commission's conclusion

The Commission concludes:

- Payment amounts mandated by legislation - as the payments that DNSPs are required to make under jurisdictional schemes, such as feed-in schemes and climate change funds, are mandated by legislation, a new cost recovery mechanism would be appropriate to address the recovery of these payments;

²⁰ The pass through mechanism is set out under clause 6.6.1 of the Rules.

²¹ The factors the AER is to take into account in making a pass through determination are set out in clause 6.6.1(j) of the Rules.

²² Requirements for a DNSP to provide evidence in its application for a pass through is set out in clause 6.6.1(c)(6) in respect of positive pass through events; and the provisions allowing the AER to consult on pass through applications is set out in 6.6.1(l).

²³ Clause 6.18.6 of the Rules.

- Pricing process - a new cost recovery mechanism would remove the need for the actual payment amounts to be considered under the distribution determination process and for adjustments for over/under recovery to be considered under the pass through process;
- Productive and administrative efficiency - a new cost recovery mechanism would provide a new mechanism for the recovery of a type of cost that otherwise would have no explicit cost recovery mechanism under the Rules. Promoting efficiency in the operation of electricity services would minimise the costs faced by DNSPs and the AER, and hence should be in the long term interest of consumers with respect to price of supply of electricity.

It would be appropriate for a DNSP to be able to make adjustments under its pricing proposals to account for any over/under recovery of payments made under jurisdictional schemes such as feed-in schemes and climate change funds. Following from this provision, the Commission notes that, if a Rule was made, consequential amendments would be required to exclude such an adjustment from the "permissible percentage" that restricts the extent the weighted average revenue for a DNSP may change from one regulatory year to the next.

6 Allocation of risks

This chapter sets out the Commission's considerations in relation to how the risks associated with forecasts of operating expenditure under the distribution determination process would be taken into account under the current provisions in the Rules.

6.1 Rule Proponent's view

Under the current treatment of the recovery of payments made under feed-in schemes, a DNSP would be required to produce a five-year forecast of the payments that it may make during its regulatory control period. The Rule Proponent considers that the level of payments that a DNSP would be required to make would be subject to various factors outside of the DNSP's control. Hence, the Rule Proponent argued that a forecast made up to five years in advance, despite the DNSP's best efforts, could "be significantly inaccurate due to the behaviour of other parties".²⁴ The Rule Proponent submitted that DNSPs would "inefficiently be asked to bear the risk" of these forecasting errors.²⁵

6.2 Stakeholders' views

Stakeholders agreed in principle with the Rule Proponent's views on this issue. In addition, some stakeholders considered that adjusting over/under recovery through the pass through mechanism would, in effect, delay the adjustment by two years. These stakeholders argued the proposed Rule would contribute to allocative efficiency by allowing adjustments for over/under recovery to be made through the annual pricing proposal process.

Additional details of the issues raised by stakeholders are provided in Appendix A.

6.3 Commission's analysis

In considering this issue, the Commission has given consideration to the current requirements for forecasts to be produced under the Rules compared with the proposed provisions in the Rule Change Request.

6.3.1 Risk of forecasting error and transparency of reporting

Any prudent operator of a distribution business would put in place mechanisms and processes to enable it to carry out its business and regulatory obligations. This would include appropriate mechanisms for forecasting business requirements including operating expenditure and capital expenditure. However, as with forecasts of any

²⁴ ETSA Utilities Rule Change Request, p. 7.

²⁵ *ibid*

nature, there are inherent risks that the actual outcomes would differ from the forecast values. Businesses have the ability to minimise these risks by ensuring that the forecasting methods adopted are robust and steps are taken to reduce forecasting errors. In the case of forecasting the level of payments that would be required under a feed-in scheme, the Commission acknowledges the factors that would need to be taken into account would largely be outside the control of DNSPs.²⁶

For this reason the Commission considers that the risks presented by potential forecasting errors would be reduced by providing for the recovery of payments under jurisdictional schemes under the annual pricing process, as discussed in section 5.3.1. Although DNSPs would still be required to produce a forecast under an annual pricing process, the forecast would be an annual forecast using the latest available information. This annual forecast would likely be more accurate than a five-year forecast under the revenue process.

However, given the potential for errors in any forecast, there should be a level of clarity and transparency in the way in which DNSPs would report to the AER on how it intends to recover the payment amounts and make any adjustments for over/under recovery. That is, although a mechanism for the recovery of these payments should be included in the pricing process, DNSPs should include information on its reporting methodology in its regulatory proposals.

6.3.2 Efficiency and accuracy of payment forecasts

Under the current treatment of the recovery of payments under feed-in schemes, where the amount of money actually recovered by a DNSP differs from the forecast amount, the pass through mechanism would be employed to make any adjustments as discussed in section 5.3.2. Following the receipt of the pass through application, the AER would have up to 60 business days to make a determination for any positive change event.²⁷ Once the AER has made a determination, the DNSP would be able to make its revenue adjustments in the next regulatory control year, which may be up to two years after the variation in cost recovery occurred.

Including an ability for adjustments for under/over recovery to be made through the annual pricing proposal process, adjustments for over/under recovery could be made more quickly. This would increase the likelihood that the customer base from which the costs are recovered from are reflective of the customers in relation to whom the costs were initially incurred.

²⁶ For example, some of the factors that may need to be taken into account in forecasting the required payments under a feed-in scheme would include the rate of take up of eligible installations; the average capacity of these installations; and the interaction of the scheme with other regulated schemes/programs.

²⁷ Clause 6.6.1(e)

6.4 Commission's conclusion

The Commission concludes:

- Efficiency and accuracy of payment forecasts - there should be a process that would likely lead to DNSPs being able to produce more accurate forecasts and allow for costs to be recovered closer to the time they were incurred. This would reduce the risks faced by businesses and consumers arising from forecast errors, which would reduce the costs to business of managing these risks, and hence should be in the long term interest of consumers with respect to price of supply of electricity; and
- Transparency of reporting - reporting requirements would provide transparency to the processes being adopted by DNSPs and, hence, better balance the interests of consumers and businesses.

7 Accommodating future schemes

This chapter sets out the Commission's consideration on how payments made under any future schemes to be introduced by jurisdictions should be treated.

7.1 Rule Proponent's view

In the Rule Change Request, the Rule Proponent noted that jurisdictions had introduced, or were in the process of introducing, feed-in schemes and that NSW had in place a Climate Change Fund. The Rule Change Request also noted that "[t]here is the potential ... that more such schemes would be introduced".²⁸

7.2 Stakeholders' views

Most stakeholders supported the principle that DNSPs should be able to use the mechanism under the proposed Rule, if made, to recover payments made under current and future feed-in schemes or climate change funds. However, one stakeholder noted that it may be difficult in practice to determine which schemes should be included.

Additional details of the issues raised by stakeholders are provided in Appendix A.

7.3 Commission's analysis

The Commission's analysis on how any new schemes should be accommodated is set out as follows.

7.3.1 Whether new schemes should be accommodated

Giving consideration to the revenue and pricing principles, including ensuring that DNSPs are provided with reasonable opportunity to recover efficient costs, the Commission considers that DNSPs should be able to recover any costs that are imposed on DNSPs in their capacity as DNSPs under legislation and where there are no other means of recovering those costs.²⁹ The Commission also considers there is some likelihood that other schemes similar to the current feed-in schemes and climate change fund would be introduced in the future. For these reasons, the Commission considers the provisions should be put in place to accommodate the recovery of payments when they are required to be made under future schemes.

If the proposed cost recovery mechanism did not apply to new schemes, DNSPs would potentially need to attempt to recover any payments to be made through a pass through application or by including the provisions as operating expenditure in its regulatory proposal. As discussed in section 5, some aspects of these cost recovery

²⁸ ETSA Utilities Rule Change Request, p. 1.

²⁹ This would exclude payments in nature of fines, penalties or incentives.

processes may not present the most efficient option. Allowing a new cost recovery mechanism to apply to future schemes would contribute to productive efficiency by removing the potential requirement for the recovery to be considered under the distribution determination and/or pass through process.

The Commission considers that criteria should be established to ensure that any future schemes would be consistent with the intent of any Rule to be made. One of the key considerations under the Rule Change Request is that the recovery of the payment amounts mandated under legislation should not be required to be assessed under the distribution determination process as the payment amounts are unrelated to a DNSP's efficiency. This consideration should be reflected in the criteria. That is, in order for the proposed new cost recovery mechanism to apply to any future schemes, the amounts to be paid must be specified in, or determined in accordance with legislation and not in nature of a fine, penalty or incentive.

The criteria should also specify that there are no specific cost recovery mechanisms set out in the relevant legislation (or that the legislation specifically refers to the recovery of payments to be addressed under the Rules). This criterion would be included for clarity to ensure that, where cost recovery provisions have been specified, there would be no conflict between the provisions under the Rules and other regulatory instruments.

In addition, the Commission considers that an additional factor should be included in the criteria such that the obligations under the scheme need to be imposed on DNSPs in their capacity as DNSPs. This would be required as the Commission's Rule making powers relate to the regulation of prices charged or that may be charged by DNSPs for the provision of distribution network services.³⁰

That is, the criteria a future scheme would need to meet in order for the new cost recovery mechanism to apply should be:

- the scheme is a jurisdictional/government mandated scheme (either through legislation or licence conditions or any other relevant instruments);
- the scheme does not specify any cost recovery methods or the scheme specifies that the payments be recovered under the Rules;
- the amount of the payments to be made by DNSPs are specified or determined in accordance with the relevant instruments;
- the obligations are imposed on DNSPs in their capacity as DNSPs; and
- the payments are not in the nature of a fine, penalty or incentive.

³⁰ For example: if a DNSP was also the operator of the water distribution system in its jurisdiction, any obligations imposed on that DNSP in its capacity as the operator of the water distribution system would not be covered by the Rules. The Commission's power to make the Rule is discussed in section 2.3.

7.3.2 Introduction of a new scheme

Having established a criteria that new schemes would need to meet, the Commission considers it would be appropriate to include provisions to outline a process for new schemes to be considered. The Commission considers that the AER should be the body to determine whether any new schemes meet the eligibility criteria. This provision would be consistent with the AER's obligations under Chapter 6 of the Rules.

As discussed in section 6.3.1 the AER would make a decision in the distribution determination on how a DNSP would report on the recovery of the payments under jurisdictional schemes. If a new scheme were to be introduced part way through a regulatory control period, DNSPs should make an application to the AER to set out its reporting methods for approval. Provisions outlining the process to be followed by DNSPs and the AER in the event a scheme is introduced part way through a regulatory control period would therefore need to be set out. The Commission considers such a process would provide transparency and clarity on the processes undertaken by a DNSPs.

7.4 Commission's conclusion

The Commission concludes:

- Productive efficiency - allowing payments to be made under future schemes, subject to the schemes meeting the criteria, would contribute to productive efficiency by removing the potential requirements for the payments to be considered under the distribution determination/pass through provisions. Promoting productive efficiency would minimise the costs faced by DNSPs and the AER, and hence should be in the long term interest of consumers with respect to price of supply of electricity;
- Applicable schemes - for clarity, the current schemes to which a new cost recovery mechanism would apply should be set out and clear criteria for any future schemes should be defined;
- Approving the reporting requirements - a process for the AER to decide on the reporting process undertaken by a DNSP for any new schemes would provide transparency and clarity on the processes undertaken by DNSPs.

8 Transitional provisions

This chapter sets out the Commission's consideration on whether transitional provisions would be required if a Rule was to be made.

8.1 Rule Proponent's view

Given that the jurisdictional provisions differ in the commencement date of the schemes and arrangements that may already have been made for cost recovery, the Rule Change Request outlined that specific transitional provisions would need to be considered.³¹

8.2 Stakeholders' views

Stakeholders generally agreed that transitional provisions should be in place to ensure that DNSPs would be able to use any new cost recovery provision in a timely manner. It is noted that although ActewAGL agreed with the principles of the Rule Change Request, it considered that given the ACT determination for the 2009-2014 regulatory control period has already been made, it would not be appropriate to require ActewAGL to adopt any new mechanism in the current regulatory control period.³²

EnergyAustralia also noted that although the transitional Chapter 6 provisions provide a mechanism under the pricing provisions (similar to the proposed Rule) for the recovery of payments DNSPs make to the NSW Climate Change Fund, there are no provisions for any over/under recovery to be adjusted. In addition, EnergyAustralia noted that these existing provisions would need to be added to general Chapter 6 of the Rules to allow NSW DNSPs to continue its recovery of payments made to the Climate Change Fund after the transitional Chapter 6 provisions expire.³³

The NSW Government considered that any new cost recovery provisions should be able to be used by NSW DNSP's immediately.³⁴

³¹ With respect to arrangements that may already have been made for cost recovery of payments under feed-in schemes and climate change funds, it is noted that for: ActewAGL, provisions are included for the payments as a component of its operating costs outlined in its distribution determination for the regulatory control period 2009-2014; ETSA Utilities, provisions are included for the payments as a component of its operating costs outlined in its draft distribution determination for the regulatory control period 2010-2015; Queensland DNSPs, provisions are included for the payments as a component of their operating costs outlined in their draft distribution determination for the regulatory control period 2010-2015; New South Wales DNSPs, provisions are included in the transitional Chapter 6 provisions for the recovery of payments made under the Climate Change Fund; Victorian DNSPs, provisions are included in the feed-in legislation specifying payments for the scheme in the current regulatory control period should be recovered under the pass through mechanism under the Rules.

³² ActewAGL, submission to the first round of consultation, 12 February 2010, p. 1.

³³ EnergyAustralia, submission to the first round of consultation, 12 February 2010, p. 6.

³⁴ NSW Department of Industry and Investment, submission to the first round of consultation, 12 February 2010, p. 3.

Additional details of the issues raised by stakeholders are provided in Appendix A.

8.3 Commission's analysis

The Commission's analysis on the relevant requirements for transitional provisions are set out as follows.

8.3.1 General transitional provisions

If a Rule was to be made, the Commission considers there would be merit in allowing any new cost recovery mechanism to be implemented by DNSPs in their current regulatory control periods. This would allow the administrative efficiency as discussed in section 5 to be realised for DNSPs and the AER. For this reason, transitional provisions should be established to allow the DNSPs to utilise the new cost recovery mechanism in a timely manner. Any process established should provide clarity and certainty to ensure a smooth transition from decisions made under the current arrangements to the new provisions.

However, the Commission notes that the general policy approach has been to not interfere with actions previously taken or decisions made under the existing regulatory framework. Distribution businesses make investment decisions into the future based on decisions made under the distribution determination process. Taking this into consideration, the ability to transition to the new cost recovery mechanism should be optional for DNSPs. This would provide a balance between the potential benefits that may be gained with maintaining regulatory certainty. This balance would be in the interest of the market as regulatory certainty contributes to good decision making by businesses.

The Commission notes that a distribution determination has already been made for ActewAGL for its current regulatory control period which sets out the recovery of payments made under the ACT feed-in scheme and that similar provisions would also likely be in place for ETSA Utilities, Ergon Energy and Energex prior to the finalisation of this Rule Change Request.³⁵ For this reason, any transitional provisions would need to include a process for the AER to make a revocation and substitution of a DNSP's distribution determination. This would allow the operating expenditure forecasts to be revised in order to remove the component for tariff payments to be made under feed-in schemes. This amendment of the distribution determination would be necessary to ensure that there would be no "double counting" of the recovery amounts. The process for this revocation and substitution of the distribution determination should be consistent with the current process for revocation and substitution of distribution determination under the Rules.³⁶ The provisions should require the AER to consult

³⁵ Under the required timeframes specified by the Rules, it is expected that the AER will publish the final distribution determination for the 2010-2015 regulatory control period for ETSA Utilities, Ergon Energy and Energex by April 2010.

³⁶ Clause 6.13 of the Rules provides for the AER to make a revocation and substitution of a distribution determination for wrong information or error.

with the DNSP prior to making a determination and not set out specific timeframes. These provisions would provide certainty to the DNSP as well as flexibility to both the DNSP and the AER to ensure that sufficient time is available to discuss relevant issues.

In addition, the transitional provisions should also require the DNSP to outline to the AER how it would report on its recovery of payments under the relevant jurisdictional scheme for that DNSP. This requirement would ensure there would be transparency on the reporting to be adopted going forward.

8.3.2 New South Wales and ACT transitional provisions

The Commission notes that no provisions were made in the NSW DNSPs' 2009-2014 distribution determinations for the payments that the DNSPs would be required to make under the NSW Solar Bonus Scheme, which commenced on 1 January 2010. In this case, if the Rule was made, the AER would not be required to make a revocation and substitution of the NSW DNSPs' distribution determinations. NSW DNSPs should be able to apply the proposed new cost recovery mechanism directly subject to meeting the relevant transitional reporting requirements. As discussed in section 5.3.1, the Commission notes that the proposed new mechanism would only provide for the recovery of the actual payment amounts that the NSW DNSPs would be required to make, which would not include any operating or capital expenditure required to administer the scheme or carry out system upgrades.

The Commission also acknowledges the issue raised by EnergyAustralia regarding there being no mechanism under the transitional Chapter 6 provisions for any over/under recovery of the payments made to the NSW Climate Change Fund to be adjusted. The Commission considers that an appropriate mechanism should be added to allow NSW DNSPs to adjust any over/under recovery of payments made to the NSW Climate Change Fund under the pricing process in the transitional Chapter 6 as the payments to be made are imposed on DNSPs by legislation. The Commission considers that, if the Rule is made, the NSW DNSPs would be able to utilise the new cost recovery provisions in the general Chapter 6 for subsequent regulatory control periods for the recovery of payments made under the Climate Change Fund.

8.4 Commission's conclusion

The Commission concludes:

- Timely implementation - transitional provisions to allow the new cost recovery mechanism to be implemented in a timely manner should be included which would allow the potential efficiency gains to be realised sooner;
- Regulatory certainty - however, to balance the potential benefits with maintaining regulatory certainty, utilising the new cost recovery mechanism should be optional for DNSPs during the current regulatory control period; and
- NSW and ACT provisions - provisions for NSW and ACT should be included to address specific NSW issues arising from the Rule Change Request.

Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Commission	see AEMC
DNSPs	distribution network service providers
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEO	National Electricity Objective
NER	National Electricity Rules
Rule Proponent	ETSA Utilities
Rules	see NER

A Summary of issues raised in submissions

The first round of consultation on the Rule Change Request closed on 12 February 2010. In total, nine submissions were received. The issues raised in the submissions, and the AEMC's responses to these issues, are summarised in the following table.

Stakeholder	Issue ³⁷	AEMC Response
General comments		
ActewAGL Distribution (ActewAGL)	Supports in principle the mechanism proposed, however considers that clarification is required regarding the scope of the mechanism and the transitional arrangements. p. 1.	Specific transitional provisions have been developed to allow DNSPs to "opt in" to use the new cost recovery mechanism in the current regulatory control period. That is, it would not be a mandatory requirement to adopt the new mechanism in the current regulatory control period. Additional discussion is outlined in chapter 8.
CitiPower and Powercor	Supports the proposed Rule change. p. 1.	Comments have been noted.
EnergyAustralia	Supports the proposed Rule and considers the proposed mechanism is more appropriate than recovering the costs through the building block determination. p. 1.	Comments have been noted. Discussion on the building block distribution determination process is provided below and in chapter 5.
EnergyAustralia	Considers the proposed process would provide greater transparency to customers on the costs incurred under the schemes.	Comments have been noted. Discussion on transparency to customers is outlined in chapter 6.

³⁷ Page numbers refer to page numbers in the stakeholder's submission to the first round of consultation.

Stakeholder	Issue ³⁷	AEMC Response
EnergyAustralia	Considers the AEMC could include a provision which specifically identifies the relevant schemes at the date when the Rule is made. However, this would not preclude other schemes that meet the general definition. However, considers that only feed-in schemes and climate change funds should be subject to the provisions. Appendix p. 5.	Comments have been noted. The Draft Rule would apply to the existing schemes as specifically set out under the Rules. The Draft Rule also sets out eligibility criteria that would apply to any new jurisdictional scheme.
Energex	Supports the intent of the Rule change request and agrees with the rationale provided by the Rule Proponent. p. 1.	Comments have been noted.
Ergon Energy	Is generally supportive of the intent of the Rule Change Request. p. 1.	Comments have been noted.
Integral Energy	Supports the proposed amendments and submits that they be implemented immediately for distributors in NSW to assist the effective implementation of the NSW Solar Bonus Scheme. p. 1.	Comments have been noted. Transitional provisions for NSW DNSPs have been included and would provide for the new cost recovery mechanism to be implemented in the current regulatory control period. Additional discussion is outlined in chapter 8.
AER	Does not consider the Rule change should be treated as non-controversial as it gives rise to broader issues with the regime that need to be resolved. p. 2.	Comments have been noted.
EnergyAustralia	Considers the AEMC should expedite the Rule Change Request and include transitional provisions for NSW. p. 2.	Comments have been noted. Transitional provisions have been included as outlined in chapter 8.
AER	Supports in principle a Rule change that made clear to customers the costs of regulatory obligations, such as feed-in schemes, particularly where the services are not associated with the provision of distribution services. p. 3.	Comments have been noted.

Stakeholder	Issue ³⁷	AEMC Response
NSW Department of Industry & Investment (DII)	Notes that the NSW Government supports the overall principle outlined in the Rule Change Request as it would provide certainty of cost recovery for distributors for payments under feed-in schemes and climate change funds. p. 1.	Comments have been noted.
DII	Supports the payments made under the NSW Solar Bonus Scheme to be recovered from all NSW electricity customers. p. 2.	Comments have been noted.
Origin Energy	Considers that whatever methodology is chosen [for the recovery of these payments by DNSPs], it needs to align clearly and appropriately with the retail price methodologies in each jurisdiction. This is necessary to ensure that the regulated retail price in each jurisdiction enables full recovery of this charge in network costs. If it does not, then retailers will find themselves exposed to yet another unmanageable financial risk. p. 1.	The Commission considers that the payments made under jurisdictional schemes are imposed on DNSPs in their capacity as DNSPs. The Commission considers the recovery of the payments may be charged as a part of the price for providing distribution services. Additional discussion is outlined in section 3.2.
AER	Notes that the feed-in tariff schemes to date have not indicated how the costs of the scheme should be recovered from customers. The pricing principles and the regulatory obligations on the DNSPs do not state which tariff classes should be targeted for the allocation of costs. While it is possible to make certain assumptions, it would be preferable if there was an explicit statement made in either the NER or in the regulatory obligations imposed on the DNSPs as to how the costs should be recovered. pp. 3-4.	The Commission notes the issues raised and agrees that how costs are to be recovered should be clarified. The Commission notes that these issues, however, are outside the scope of the Rule Change Request and that policy makers would be required to provide direction on these issues in the relevant legislation establishing the schemes.

Stakeholder	Issue ³⁷	AEMC Response
DNSP's operational costs and system costs		
EnergyAustralia	Notes that there are two types of costs associated with these schemes - the payments made to eligible customers and the costs associated with administering the scheme. Notes that it agrees the costs associated with administering the scheme should be recovered through the building block determination/pass through mechanism. p. 2.	The Commission agrees that the costs of administering a jurisdictional scheme, such as a feed-in scheme or climate change fund, should be subject to the appropriate efficiency considerations. The new cost recovery mechanism should only be used to recover the actual payment amounts that are mandated by legislation.
AER	Notes that the Rule Change Request considers any assessment of efficiency in regard to feed-in tariff schemes as being needless. Notes that while this may be true in regard to the tariff payment, the administrative costs of such a scheme would be controllable by a regulated business and would give rise to efficiency considerations. p. 1.	As noted above, the Commission agrees with the principle that costs for administering a jurisdictional scheme would be a cost that was controllable by a regulated business.
DII	Notes that the tariff credited by DNSPs under the NSW Solar Bonus Scheme should be recovered through the proposed Rule change; whereas additional administrative costs such as costs to establish billing and reporting systems and the ongoing cost of meeting these requirements should be recovered through the normal regulatory determination process. p. 3.	As noted above, the Commission agrees with the principle that costs for administering a jurisdictional scheme would be controllable by a regulated business.
Use of the distribution determination process		
EnergyAustralia	Considers that payments made under feed-in schemes or climate change funds are payments outside the control of the distributor and therefore should not be subject to the incentives under a building block approach. p. 4.	The Commission agrees with this in principle. Additional discussion is outlined in chapter 5.

Stakeholder	Issue ³⁷	AEMC Response
EnergyAustralia	Considers that the payments made under feed-in schemes and climate change funds cannot be controlled or influenced through more efficient behaviour by the distributor. p. 4.	The Commission agrees with this in principle. Additional discussion is outlined in chapter 5.
Energex	Agrees that an ex-post assessment of actual payments is required as DNSPs do not have any control over the payments made under feed-in schemes and climate change funds. p. 1.	The Commission agrees with this in principle. Additional discussion is outlined in chapter 5.
AER	Distribution businesses' recovery the costs of these types of initiatives [feed-in schemes/climate change funds] through their chapter 6 determination is currently problematic. It is uncertain whether a number of these initiatives would fit within the definition of a distribution service for the purpose of chapter 6 of the NER. If the costs (or some of the costs) of these initiatives are to be recovered through the chapter 6 building block determination process, it is vital that the National Electricity Law and the NER clearly allow for this and the limitations in the current regime be addressed. p. 2.	The Commission agrees with this in principle. Additional discussion is outlined in chapter 5.
DII	Considers that it is important that DNSPs are able to recover legitimate costs imposed on them either from Government or transmission businesses (as with transmission use of system charges), particularly where these costs are not able to be influenced by the behaviour of DNSPs, even where more efficient operating procedures are implemented. p. 4.	The Commission agrees with this in principle. Additional discussion is outlined in chapter 5.

Stakeholder	Issue ³⁷	AEMC Response
DII	Considers the Rule Change Request, if the proposed Rule were to be implemented, would provide greater clarity to DNSPS in recovering legitimate costs which DNSPs are not able to control through increases in efficiency; it reduces the administrative burden on the AER and DNSPs in pursuing cost pas through applications for feed-in tariff payments and recovery of shortfalls in network charges to cover costs under the [relevant funds]. p. 4.	The Commission agrees with this in principle. Additional discussion is outlined in chapter 5 and chapter 6.
Function of the pass through mechanism		
EnergyAustralia	Notes that under the pass through mechanism the AER would be required to assess each application in accordance with the Rules and any materiality threshold that applies, potentially on an annual basis. Considers that this annual process would be administratively cumbersome. Further considers it is unclear under the Rules where a distributor would obtain a pass through of costs to correct for under and over recovery of revenue in the last year of a regulatory control period. p. 5.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 5.
Energex	The pass through process under the Rules is considered to be more administratively burdensome on the DNSP and the AER than the determination of an adjustment factor for annual pricing. p. 1.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 5.
Ergon Energy	Believes that the Rule change is necessary in that an under-and-overs revenue adjustment for each regulatory year is more administratively simple to operate than the current approach proposed by the AER in Ergon's draft distribution determination. p. 1.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 5.

Stakeholder	Issue ³⁷	AEMC Response
Ergon Energy	Considers there is uncertainty with the pass through process for adjusting any over/under recovery as it is not yet known what level of detail and justification Ergon Energy will be required to provide as a part of this process. Any adjustments to the annual revenue requirement would take effect two years after the year in which the actual results differ from the forecast. p. 4.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 5.
DII	Considers that there is a degree of uncertainty as to what criteria, including materiality or level of costs, need to be met before the AER will allow these costs [for the NSW Solar Bonus Scheme] to be passed through. This uncertainty is heightened by the difficulty for DNSPs in forecasting costs under the scheme which are dependent on rates of uptake of small-scale generation by customers which are outside of DNSPs' control. p. 2.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 5.
Forecasting and allocative efficiency		
EnergyAustralia	Notes that the building block approach requires a five year projection of payments, while a pricing proposal is based on a yearly forecast which incorporates latest information on take-up rates and payment levels. There will consequently be less forecasting error under the proposed process. p. 5.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 6.
Energex	Considers that the dynamic nature of an annual adjustment mechanism can enhance the cost-reflectivity of annual distribution prices. Under the current treatment, the annual forecast and pass-through component reflect forecasts made up to five (or more) years previous to the year which they relate. An annual pricing adjustment mechanism would allow the components to reflect estimates made no more than two years previous to the year which they relate. p. 1.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 6.

Stakeholder	Issue ³⁷	AEMC Response
Ergon Energy	Considers the Rule Change Request allows for greater accuracy in forecasting payments under a feed-in scheme, as the forecasts can be done annually as part of the pricing proposal process rather than for a five year period prior to the commencement of the regulatory control period. p. 1.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 6.
Ergon Energy	Considers that forecasting payments under feed-in schemes is highly uncertain as the forecasts are based on projections of the behaviour of others over which DNSPs have no control. Considers that providing a five year forecast as part of a distribution determination process results in significant uncertainty for DNSPs and customers. pp. 2-3.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 6.
Integral Energy	Considers the proposed Rule change would minimise the uncertainty surrounding customer numbers and usage forecasts by applying a transmission use of system charges type cost recovery arrangement, which improves allocative efficiency and minimises the administrative burden on DNSPs. It also minimises the potential distortion in prices through an over and under recovery mechanism which is adjusted annually. pp. 2-3.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 6.
AER	Notes that under the proposed Rule, forecasts of payment amounts would still be required for the year ahead; an efficiency assessment would (presumably) still be needed in terms of any controllable costs; forecast errors would still occur and an adjustment would still be required. p. 4.	Comments have been noted. The Commission notes that DNSPs would still be required to produce annual forecasts under the Draft Rule. However, it is likely that annual forecasts would be more accurate than five-year forecasts that would be required under the distribution determination process. Additional discussion is outlined in chapter 6.

Stakeholder	Issue ³⁷	AEMC Response
DII	Considers that if the direct costs of these schemes are passed on to customers on an annual basis and reconciled each year through the unders and overs mechanism, network charges for customers associated with these costs are likely to be passed on closer to the time that the costs were incurred by DNSPs. p. 4.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 6.
Scope of the proposed new mechanism		
ActewAGL	Considers the scope of the cost recovery mechanism must be clear and extend beyond photovoltaic schemes and accommodates all current and future renewable energy schemes. p. 2.	Comments have been noted. The scope of the new cost recovery mechanism under the Draft Rule does extend beyond photovoltaic schemes. Additional discussion is outlined in chapter 7.
Ergon Energy	Considers the any new process should be flexible enough to allow the various methodologies currently employed in various jurisdictions to be included. That is, the Rule change should not require the recovery of payments through individual specified components in the tariff and therefore network bill. pp. 1-2.	Comments have been noted. The DNSP would be required to specify the relevant schemes to which the cost recovery relates under the pricing proposal. However, no additional requirements have been included that would require DNSPs to specify the components in the network bill.
Ergon Energy	Considers it appropriate that given the schemes and funds are mandated by state governments, it would be appropriate for the Rules to include a set of criteria that a scheme would need to meet in order to use the cost recovery mechanism. Suggests that criteria specify that the scheme or fund is mandated by government; and has a regulatory requirement on the DNSP to make payments. p. 5.	Comments have been noted. Additional discussion is outlined in chapter 7.

Stakeholder	Issue ³⁷	AEMC Response
AER	Considers the proposed Rule would have the benefit of more transparently delineating costs associated with the provision of distribution services from the costs of certain types of regulatory obligations, like feed-in tariffs. Considers that, under such arrangements, the AER would have more of an audit function with regards to the recovery of payments under feed-in schemes. p. 1.	Comments have been noted. Additional discussion is outlined in chapter 6 and chapter 7.
AER	In regards to climate change funds, in the absence of more detail about the programs it is unclear whether the approach proposed would be appropriate or not. The initiative may not be as simple as the straight forward pass through of a cost over which a DNSP has no control. p. 2.	Comments have been noted. Additional discussion is outlined in chapter 7.
Transitional arrangements		
ActewAGL	Has concerns on the transitional arrangements. Does not believe the proposed Rule should provide grounds for reopening and amending the ACT determination. Considers it would not be appropriate to require ActewAGL to adopt the new mechanism as its determination has already been made. p. 2.	Comments have been noted. Under the Draft Rule, adopting the new cost recovery mechanism in the current regulatory control period would not be mandatory (however, it would be mandatory for subsequent regulatory control periods). DNSPs would be able to "opt in" to use the new arrangements in the current regulatory control period. Additional discussion is outlined in chapter 8.
Ergon Energy	Supports AEMC having due regard of the impact a Rule change will have on Ergon Energy's distribution determination when contemplating this proposed amendment to the Rules. Considers the AEMC should ensure that there is a transitional arrangement whereby Ergon Energy can immediately apply the Rule, therefore requiring an amendment to Ergon Energy's distribution determination. However, this is subject to the Rule change not specifying the way the payments should be recovered through network tariffs. p. 4.	Comments have been noted. Additional discussion is outlined in chapter 8.

Stakeholder	Issue ³⁷	AEMC Response
NSW transitional provisions		
EnergyAustralia	Noted that the proposed Rule does not seek to make any amendments to the transitional Chapter 6 provisions that apply to NSW and ACT. Considers that such amendments would be required. p. 6.	Comments have been noted. Additional discussion is outlined in chapter 8.
EnergyAustralia	With the introduction of the NSW Solar Bonus Scheme for which DNSPs' costs have not been taken into account in their distribution determinations, considers that NSW DNSPs are at a disadvantage compared to other jurisdictions such as ActewAGL which have an allowance for payments incorporated into its X-factors. p. 6.	Comments have been noted. The Draft Rule provides for the recovery of these payments under the pricing process and includes the consequential amendment which would allow such an adjustment to be excluded from the "permissible percentage" calculations. Additional discussion is outlined in chapter 5.
EnergyAustralia	Considers that NSW DNSPs are exposed to uncertainty under the current Rules. It considers that any applications for pass through amounts to address the costs incurred under the Solar Bonus Scheme could be unsuccessful and, if successful, it is uncertain whether the pass through applications could be made to adjust for over and under recovery. p. 7.	Comments have been noted. The Draft Rule would provide NSW DNSPs with the option to "opt in" to the new cost recovery mechanism and thereby address the concerns raised. Additional discussion is outlined in chapter 8.
EnergyAustralia	Considers that the transitional Chapter 6 Rules should also be amended to provide for the recovery of payments made under the NSW Solar Bonus Scheme. p. 7.	Comments have been noted. Transitional provisions have been included. Additional discussion is outlined in chapter 8.
EnergyAustralia	Although the transitional Chapter 6 includes provisions for NSW DNSPs to recover under the pricing provisions payments made to the Climate Change Fund, EnergyAustralia notes there are no provisions to allow for the adjustment of any over/under recovery. Appendix p. 1.	Comments have been noted. Provisions have been added to allow adjustments for over/under recovery for payments made to the NSW Climate Change Fund to be made. Additional discussion is outlined in chapter 8.

Stakeholder	Issue ³⁷	AEMC Response
Integral Energy	Given the NSW Solar Bonus Scheme commenced on 1 January 2010, submits the proposed Rule change apply immediately to NSW DNSPs to moderate price impact on customers. p. 3.	Comments have been noted. The Draft Rule would provide NSW DNSPs with the option to "opt in" to the new cost recovery mechanism and thereby addressing the concerns raised. Additional discussion is outlined in chapter 8.
DII	Requests that transitional arrangements provide for the date of effect for the rule change to apply to NSW DNSPs with immediate effect. p. 3.	The Draft Rule would provide NSW DNSPs with the option to "opt in" to the new cost recovery mechanism and thereby addressing the concerns raised. Additional discussion is outlined in chapter 8.
Drafting suggestions		
CitiPower and Powercor	Proposes drafting suggestions to 6.18.7A(c)(2) for consideration in relation to the terms used to express the amounts of money that is pass on to or actually paid by customers. p. 1	Comments have been noted. The Draft Rule introduces a defined term to explain the amounts that would be recovered under the new cost recovery mechanism. The Commission considers clarity would be provided through the definition.
EnergyAustralia	Considers the proposed amendments to the AER's constituent decision on a DNSP's reporting requirements would not be necessary as the payments are an externally imposed obligation and not an input into the costs of providing distribution services. pp. 7-8. It notes that the AER's powers under the pricing process to consider whether it is satisfied forecasts provided are accurate. p. 8.	Given that DNSPs would be required to produce an annual forecast, which would require taking into consideration factors outside the control of DNSPs, the Commission considers that an AER decision on the reporting requirements should be included to provide clarity to the process. Additional discussion is outlined in chapter 6.
EnergyAustralia	Considers the proposed amendments to provide for variations to the determination if a feed-in scheme or climate change fund commences after a regulatory determination is unnecessary and overly complicated as a regulatory determination does not need to transgress into the reporting arrangements for recovery of payments made under these schemes. p. 8.	Comments have been noted. The Draft Rule clarifies the provisions for a new scheme coming into effect part way through a regulatory period. Additional discussion is outlined in chapter 7.

Stakeholder	Issue ³⁷	AEMC Response
Energex	Considers that the proposed clause 6.12.1(19A) could be redrafted to require a constituent decision at any time prior to the next regulatory control period. p. 2.	Comments have been noted. The Draft Rule clarifies the provisions for a new scheme coming into effect part way through a regulatory period. Additional discussion is outlined in chapter 7.
Energex	Considers that the proposed clause 6.12.1(19B) could be reconsidered to allow DNSPs to propose a methodology to adjust tariffs relating to distribution determinations made prior to the Rule coming into force.	Comments have been noted. The Draft Rule clarifies the provisions for a new scheme coming into effect part way through a regulatory period. Additional discussion is outlined in chapter 7.