



Australian Energy Market Commission

## CONSULTATION PAPER

National Electricity Amendment (Participant  
derogation - NSW DNSPs revenue smoothing)  
Rule 2016

**Proponents**

Ausgrid  
Endeavour Energy  
Essential Energy

National Electricity Amendment (Participant  
derogation – ACT DNSP revenue smoothing)  
Rule 2016

**Proponent**

ActewAGL

17 November 2016

RULE  
CHANGE

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## **About the AEMC**

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

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# Contents

<b>1</b>	<b>Introduction .....</b>	<b>1</b>
<b>2</b>	<b>Background .....</b>	<b>2</b>
2.1	Overview of economic regulation of electricity network businesses.....	2
2.2	Distribution determinations relevant to this rule change request.....	5
2.3	Aspects of a distribution determination that is relevant to the request .....	6
<b>3</b>	<b>Rule change requests.....</b>	<b>9</b>
3.1	Rationale for the rule change requests .....	9
3.2	Proposed solution.....	11
3.3	Variances specific to ActewAGL.....	13
3.4	Participant derogation or a wider rule change .....	14
<b>4</b>	<b>Assessment framework.....</b>	<b>15</b>
4.1	Rule making test.....	15
4.2	Proposed assessment framework .....	16
<b>5</b>	<b>Issues for consultation .....</b>	<b>17</b>
5.1	Costs and benefits of reducing pricing volatility.....	17
5.2	Mechanism for smoothing .....	17
<b>6</b>	<b>Lodging a submission .....</b>	<b>19</b>
6.1	Lodging a submission electronically .....	19
6.2	Lodging a submission by mail .....	19
	<b>Abbreviations.....</b>	<b>20</b>



# 1 Introduction

On 18 July 2016, the New South Wales distribution network service providers Ausgrid, Endeavour Energy and Essential Energy (NSW DNSPs) submitted a joint rule change request to the Australian Energy Market Commission (Commission) seeking a participant derogation to amend the National Electricity Rules (NER).<sup>1</sup> The rule change request seeks to provide a mechanism to minimise pricing volatility for New South Wales customers that may occur at the conclusion of the merits review and judicial review proceedings and the finalisation of final distribution determinations and other processes for the NSW DNSPs. The rule change request proposes to allow any required adjustments to the NSW DNSPs' revenues for the 2014-19 regulatory control period to be recovered over two regulatory control periods.

On 23 September 2016, ActewAGL submitted a rule change request seeking a participant derogation to provide a mechanism to similarly minimise pricing volatility for customers in the Australian Capital Territory. ActewAGL's rule change request references the NSW DNSPs' request and modifies it to address issues particular to its distribution determination.

As the NSW DNSPs and ActewAGL (the proponents) have outlined a similar set of issues, the Commission will assess the rule change requests concurrently. This consultation paper will cover the Commission's first round consultation for both requests. However, separate draft and final rule determinations will be made for each of the rule change requests.

This paper has been prepared to facilitate public consultation on the rule change requests and to seek stakeholder submissions. Stakeholders are encouraged to comment on these or any other aspects of the paper. If stakeholders wish to comment on issues specific to only one of the rule change requests, the Commission requests that stakeholders clearly indicate this in their submission.

Further details on providing a submission can be found in Chapter 6 of this paper.

This paper:

- sets out a summary of, and a background to, the rule change requests;
- identifies a number of questions and issues to facilitate the consultation on these rule change requests; and
- outlines the process for making submissions.

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<sup>1</sup> A participant derogation is a rule made at the request of a person who is conferred a right, or is subject to an obligation, under the NER that exempts that person or a class of person of which that person is a member, from complying with a provision of the NER; or modifies or varies the application of a provision of the NER to that person or that class of person. (s. 91(5) of the NEL).

## 2 Background

This chapter outlines key information to provide background and context to the rule change requests. It includes:

- an overview of the economic regulation of electricity network businesses;
- the distribution determinations that are relevant to the rule change requests; and
- aspects of a distribution determination that are relevant to the rule change requests.

### 2.1 Overview of economic regulation of electricity network businesses

#### 2.1.1 Principles underlying regulation of electricity networks

Due to their capital intensive nature, electricity network services in a particular geographic area are most efficiently provided by one supplier and this results in a natural monopoly market structure. In the absence of competition, network service providers are regulated to encourage efficient investment and maintenance of infrastructure to meet reliability and quality of supply standards, and manage the risk of monopoly pricing.

The National Electricity Law (NEL) and National Electricity Rules (NER) set out the economic regulatory framework governing electricity networks.<sup>2</sup> The NEL and the NER set out, among other matters, the roles of regulatory bodies, the process of making distribution determinations as well as the process for the review of economic regulatory decisions. Section 2.1.2 provides an overview of the institutions involved in economic regulation and review of decisions and section 2.1.3 provides an overview of the process involved in determining revenues.

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<sup>2</sup> Jurisdictional legal instruments also provide aspects of economic regulatory framework for electricity networks.

## 2.1.2 Institutions involved in economic regulation and review of decisions

A number of regulatory institutions have roles in the economic regulation of services provided by electricity network businesses. These are set out in Table 2.1 below.

**Table 2.1 Relevant institutions involved in electricity network regulation and review of decisions**

Institution	Role
Australian Energy Market Commission (AEMC)	<ul style="list-style-type: none"> <li>• Makes the National Electricity Rules (NER)</li> <li>• The AEMC's rule making powers in respect of the NER are exercised under the NEL.</li> </ul>
Australian Energy Regulator (AER)	<ul style="list-style-type: none"> <li>• Performs economic regulatory, compliance and enforcement functions, including the determination of regulated revenues for electricity distribution and transmission network businesses</li> <li>• The AER exercises its economic regulatory powers and functions in respect of electricity networks under the NEL and NER</li> <li>• The AER's decisions are subject to merits review by the Tribunal and judicial review by the Federal Court.</li> </ul>
Australian Competition Tribunal (Tribunal)	<ul style="list-style-type: none"> <li>• Reviews determinations made by the AER in accordance with the merits review framework set out in the NEL<sup>3</sup></li> <li>• The Tribunal may affirm or vary the AER's decision, or set aside the decision and remit the matter back to the AER to consider it again in accordance with any direction from the Tribunal</li> <li>• An application for judicial review of a Tribunal's decision can be made to the Federal Court of Australia.</li> </ul>
Federal Court of Australia	<ul style="list-style-type: none"> <li>• The grounds for judicial review differ from merits review in that they relate to the legality of the administrative decision (e.g. an error of law), not the merits of the decision.</li> <li>• Applications to the Federal Court are made under the <i>Administrative Decisions (Judicial Review) Act 1977 (Cth)</i><sup>4</sup></li> </ul>

## 2.1.3 Process for electricity network distribution determinations

The AER is responsible for the making of distribution determination for electricity networks.<sup>5</sup> A distribution determination covers a regulatory control period, which is usually a five year period.

<sup>3</sup> See Division 3A of the NEL.

<sup>4</sup> The AER and Tribunal's decisions may be subject to judicial review under the *Administrative Decisions (Judicial Review) Act* .

<sup>5</sup> Clause 6.2.4 of the NER.

## **Framework and approach**

The process for a distribution network distribution determination begins with the AER publishing a framework and approach paper. The framework and approach paper must set out, among other things, the AER's determination on control mechanisms,<sup>6</sup> its proposed approach to distribution service classification, incentive schemes as well as guidelines on matters relating to expenditure forecasts. The framework and approach paper is designed to promote early consultation with stakeholders and assists the distribution network business in preparing its regulatory proposal.

## **Submission and review of a regulatory proposal**

After the AER has published its framework and approach, the network business then submits its regulatory proposal to the AER. The network business is required to consult on its regulatory proposal and take into account the views of stakeholders prior to lodgement with the AER.

Once the AER has received the regulatory proposal, it publishes it on its website and invites stakeholders to provide comments. The AER also publishes an issues paper indicating its preliminary view on the proposal to assist stakeholders who are interested in making submissions. In addition, the AER holds public forums where stakeholders have the opportunity to discuss the regulatory proposal with representatives from the network business and the AER.

## **Draft and final determination**

Once the consultation period for the issues paper has ended, the AER will consider the network business's regulatory proposal in detail and make a draft determination. The draft determination sets out the AER's assessment of all elements of the proposal, taking into account stakeholder views and other available information. Stakeholders are invited to provide submissions to the draft determination and the network business's revised regulatory proposal (submitted in response to the draft determination). At the end of the draft determination's consultation period, the AER will assess the network business's revised proposal as well as stakeholder submissions and make its final decision.

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<sup>6</sup> Under clause 6.2.5 of the NER, the AER may impose price controls over direct control services, the revenue to be derived from those services or both. The control mechanism may consist of: a schedule of prices, caps on the prices of individual services, caps on the revenue to be derived from a particular combination of services (revenue cap), tariff basket control (weighted average price cap), revenue yield control (average revenue cap) or a combination of any of the aforementioned controls. Detailed description for each of these control mechanisms can be found at AER, Stage 1 Framework and approach paper 2013 for NSW DNSPs, p. 45.



## Review of AER's distribution determination decisions

A distribution determination is a 'reviewable regulatory decision' under the NEL.<sup>7</sup> Parties that are affected<sup>8</sup> by the AER's distribution determination can apply to the Australian Competition Tribunal (Tribunal) for a review of the decision under the limited merits review framework in Division 3A of the NEL. In general terms, the affected party must demonstrate an error of fact, incorrect exercise of discretion, or unreasonableness by the AER in respect of the distribution determination.<sup>9</sup> In addition, the applicant must demonstrate why the Tribunal varying or setting aside that decision on the basis of one or more of those grounds would, or is likely to, result in a decision that is materially preferable to the existing decision in terms of making a contribution to the achievement of the national electricity objective (NEO).

If the affected party or the AER is not satisfied with the decision of the Tribunal, it may apply to the Federal Court of Australia for judicial review of the Tribunal's decision.

## 2.2 Distribution determinations relevant to this rule change request

### 2.2.1 Status of determinations and reviews

The final distribution determinations relevant to the rule change requests were made by the AER in April 2015 for the regulatory period from 1 July 2014 to 30 June 2019. These determinations are referred to as the 2015 determinations by the proponents in their rule change requests.

The proponents applied for merits review of their final determinations in May 2015. The Tribunal made its decision on 26 February 2016 to set aside the AER's decisions.<sup>10</sup> It required the AER to remake its decisions in accordance with directions made by the Tribunal. The AER has applied to the Federal Court for judicial review of the Tribunal's decision. The judicial review proceedings are still ongoing.

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<sup>7</sup> Section 71A of the NEL.

<sup>8</sup> Section 71A of the NEL provides the definition of 'affected or interested person or body' for the purposes of a reviewable regulatory decision. The definition includes: the network service provider to which the decision applies; a network service provider, network service user, prospective network service user or end user whose commercial interest are materially affected by the decision; a user or consumer association; and a reviewable regulatory decision process participant (e.g. stakeholders who have provided submission to the determination process).

<sup>9</sup> The grounds for review available under the limited merits review framework are: (a) the AER made an error (or more than one error) of fact in its findings and that error of fact (or, if more than one error, those errors in combination) was material to the making of the decision; (b) the exercise of the AER's discretion was incorrect, having regard to all the circumstances; (c) the AER's decision was unreasonable, having regard to all the circumstances. See s. 71C of the NEL.

<sup>10</sup> The application for review made by the four network businesses were heard together by the Tribunal.

### **2.2.2 Undertakings provided to the AER by the NSW DNSPs and ActewAGL**

In May 2016, the proponents gave undertakings to the AER under s. 59A of the NEL that set out the tariffs to be applied in 2016-17. The undertakings mean that the revenue recovered by the proponents during 2016-17 could be different from the amount they are entitled to recover once the outcomes of the merits and judicial reviews are known and the processes of finalising distribution determinations are completed.

### **2.3 Aspects of a distribution determination that is relevant to the request**

Network businesses provide a range of services that are regulated by the AER. A distribution determination contains a number of components that, in combination, determine the revenue that a network business is allowed to recover for services that are classified by the AER as “direct control services” over the relevant regulatory control period. The operation of some of these components has implications for the issues in the rule change requests. This section provides a brief description of these components.

It is also important to note that network businesses do not bill end customers directly for the provision of network services. Network charges are billed to retailers who then recover these charges through their retail tariffs, which are the tariffs paid by end customers.

### 2.3.1 Control mechanism

A distribution determination must impose controls over prices of (and/or revenues derived from) direct control services.<sup>11</sup> For the 2014-19 regulatory control period, the AER determined to apply a revenue cap on standard control services for the NSW DNSPs and an average revenue cap for ActewAGL. A brief description of the control mechanisms is in Box 2.1 below.

#### **Box 2.1 Revenue cap and average revenue cap**

A revenue cap sets a maximum allowable revenue (MAR) for each year of the regulatory control period. Network businesses must then recover revenue through their network charges that is equal to or less than the MAR. Network businesses comply with the constraint by forecasting electricity usage for the next regulatory year and setting prices so the expected revenue is equal to or less than the MAR. At the end of each regulatory year, the network business reports its actual revenues to the AER. The AER account for differences between the actual revenue recovered and the MAR in future years. This operation occurs through an 'overs and unders' account, whereby any over-recovery or under-recovery is deducted from (added to) the MAR in future years.

An average revenue cap is a cap on the average revenue that a network business can recover per unit of electricity used. The cap is calculated by dividing the MAR by a particular unit (or units) of output, usually kilowatt hours (kWh). The distributor complies with the constraint by setting prices so the average revenue is equal to or less than the MAR per unit of output.

Source: AER, Stage 1 Framework and approach paper 2013 for NSW DNSPs, p. 69.

### 2.3.2 Including revenue increments and decrements from a previous regulatory control period

The annual revenue requirement for a network business is to be determined using a building block approach.<sup>12</sup> Among other components,<sup>13</sup> the NER allows revenue increments and decrements arising from the application of a control mechanism in the previous regulatory control period to be carried forward to the building blocks of the determination of the subsequent regulatory control period.<sup>14</sup>

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<sup>11</sup> NER clause 6.2.5(a). "Direct control services" are classified by the AER as either "standard control services" or "alternative control services". The main focus of the rule change requests is standard control services. Most of the regulated revenues of a DNSP relate to the standard control "network service", which relates to the transportation of energy and the operation and maintenance of the network.

<sup>12</sup> Clause 6.4.3 of the NER.

<sup>13</sup> Clause 6.4.3(a) of the NER prescribes the elements of the building block approach.

<sup>14</sup> Clauses 6.4.3(a)(6) and 6.4.3(b)(6) of the NER.

### **2.3.3 Smoothing of revenue within a regulatory control period**

The revenue requirement for each year of a regulatory control period can vary as it depends on the efficient cost of operating a network business as determined by the AER. As a result, network prices could vary from year to year. Under the NER, a smoothing mechanism, the X factor, allows the AER to minimise fluctuation in average network prices by setting a 'smoothed' revenue path for the whole regulatory control period. For standard control services, the NER specifies that the X factor must be designed to equalise (in terms of net present value) the revenue earned by the network business from the provision of standard control services over the regulatory control period with the total revenue requirement for the regulatory control period.<sup>15</sup>

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<sup>15</sup> Clause 6.5.9(b)(3) of the NER.

### 3 Rule change requests

This chapter provides a summary of the rule change requests and the proposed solutions.

#### 3.1 Rationale for the rule change requests

As outlined in section 2.2, the merits and judicial review proceedings for the proponents' 2015 final determinations are ongoing. The proponents submit that when the current merits review and judicial proceedings conclude, there is a real chance that the AER will be required to remake the 2015 determinations.<sup>16</sup> The remade determinations are likely to have revenue allowances that are different to the actual revenue recovered within the current regulatory period.<sup>17</sup> This gives rise to the potential for significant adjustment amounts (positive or negative) in revenue allowances for the 2014-2019 regulatory control period.

Under current rules, any additional revenue arising from the remade final determination can only be recovered in the remaining years of the current regulatory control period. However, the proponents consider that the AER may not remake the determinations until 2018, resulting in only one year in the current regulatory period for which revenue adjustments can be recovered.<sup>18</sup> Therefore, the proponents argue that this could lead to significant price shocks for customers if the adjustment amount to be recovered in the single remaining year is substantial. Figure 3.1 illustrates the potential for price shock in the absence of a rule change. In this figure the NSW DNSPs indicate the potential revenue change that would have a direct flow on effect to prices.

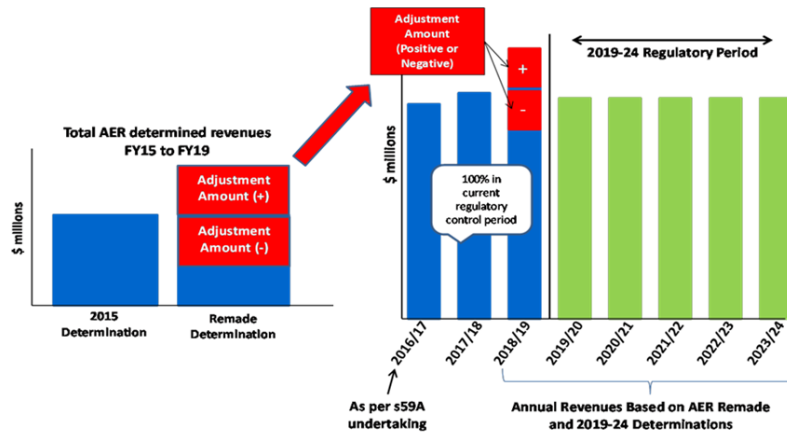
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<sup>16</sup> NSW DNSPs rule change request, p. 5; ActewAGL rule change request p. 5.

<sup>17</sup> Revenue for the 2016-17 regulatory year is set in accordance with the s. 59A undertakings provided to the AER by the proponents in May 2015. Prices for 2016-17 were increased by CPI for Ausgrid, Endeavour Energy and ActewAGL. Prices for Essential Energy were set consistent with its 2015 determination.

<sup>18</sup> NSW DNSPs rule change request, p. 4; ActewAGL rule change request p. 5.

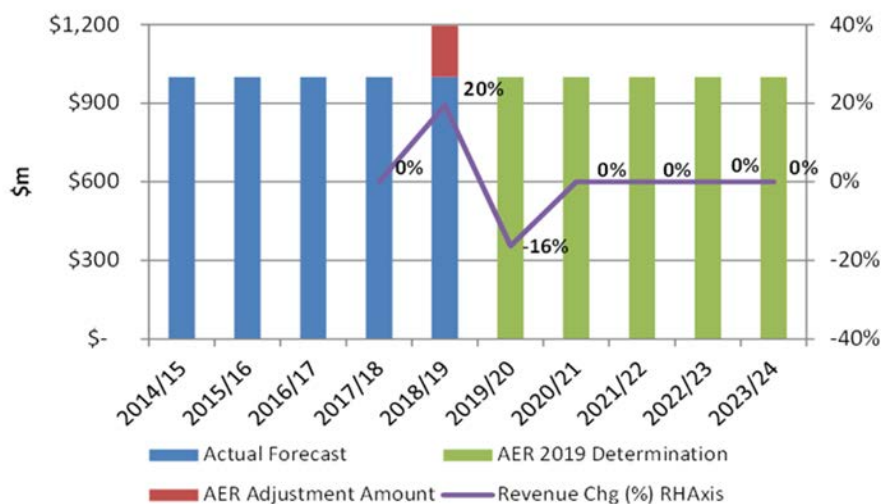
**Figure 3.1 Potential for price shock without a rule change**



Source: NSW DNSPs rule change request, p. 5.

As stated in the rule change requests there are various revenue outcomes that could arise from the remade AER distribution determinations. Figure 3.2 shows a hypothetical situation where a positive adjustment amount could lead to considerable price volatility in the absence of a rule change, with a large price increase in 2018-19 followed by a large price decrease in 2019-20.

**Figure 3.2 Indicative annual revenue change without a rule change (positive adjustment amount)**

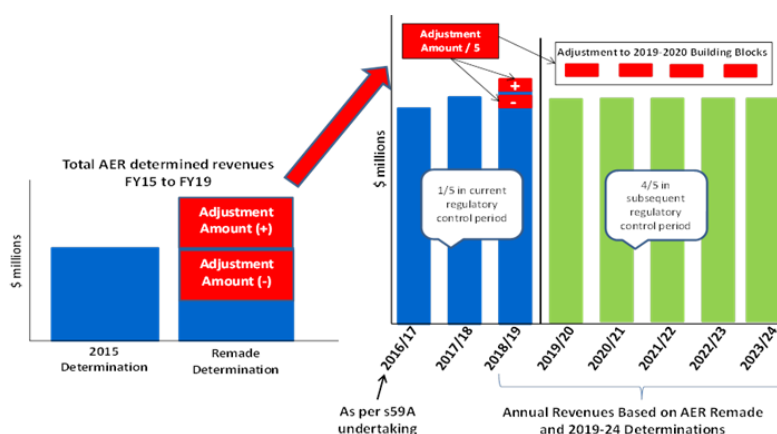


Source: NSW DNSPs rule change request, p. 6.

### 3.2 Proposed solution

In order to minimise this potential pricing volatility the proponents submitted rule change requests that would allow for any revenue adjustment amount to be smoothed over the current regulatory control period (2014-2019) and subsequent regulatory control period (2019-2024). The proposed rules as submitted by the proponents would, if made, allow for a specified proportion of any adjustment to be recovered across each of the current and subsequent regulatory control periods as shown in Figure 3.3. In effect, rather than making a revenue adjustment in a single regulatory year, the change in revenue could be spread over a number of years.

**Figure 3.3 Calculation of the adjustment amount**



Source: NSW DNSPs rule change request, p. 10.

While the illustrated scenarios show a positive adjustment amount, the rule change requests state that it is also possible that the remade distribution determinations could result in a negative adjustment amount. This would also cause pricing volatility. To manage this case the rule change requests propose the same mechanism.<sup>19</sup> In other words, the proposed rules are designed to be symmetrical. Box 3.1 below provides a high level outline of the operation of the proposed revenue smoothing mechanism. Stakeholders should refer to the rule change requests for a further explanation of how they are intended to operate.<sup>20</sup>

<sup>19</sup> NSW DNSPs rule change request, p. 4; ActewAGL rule change request p. 7.

<sup>20</sup> See NSW DNSPs rule change request, section 4.1, for a detailed description of the smoothing mechanism.

**Box 3.1 Overview of the operation of the proposed revenue smoothing mechanism**

The proposed rules provided with the rule change requests set out the following steps:

- Step 1 – Determine the adjustment amount and the allocation of this amount between regulatory control periods;
- Step 2 – Make any required adjustments in the current regulatory control period through the annual pricing proposal process to recover the relevant proportion of the adjustment amount in the current regulatory control period; and
- Step 3 – Make any required adjustments in the subsequent regulatory control period through the building block process to recover the remaining proportion of the adjustment amount in the subsequent regulatory control period.

The proponents state that the proposed rules would be implemented by the AER making a separate determination (an adjustment amount allocation determination) at the time of making the remade 2015 determination. This additional determination would set out:

- the adjustment amount for each DNSP;
- the annual adjustment amount for each remaining regulatory year of the current regulatory control period for each DNSP; and
- the expected subsequent adjustment amount for the subsequent regulatory control period for each DNSP.

Source: NSW DNSPs rule change request, pp. 11-15.

Notes:

Adjustment amount refers to the difference in revenue allowance between the remade 2015 distribution determination and the expected revenue for the 2014-19 regulatory control period.

Annual adjustment amount represents the offset to the annual revenue requirements in the current regulatory control period by the pricing proposals for the proportion of the adjustment amount that is to be recovered in the subsequent determination for the subsequent regulatory control period.

The subsequent adjustment amount represents the proportion of the adjustment amount included in the AER's remade 2015 determinations that would be recovered in the current regulatory period in the absence of a rule change, but that is targeted to be recovered in the subsequent period to minimise pricing volatility.



The proposed rules also outline circumstances where the annual adjustment amount could be varied (varied annual adjustment amount) through the annual pricing proposal process if this would better minimise variations in network charges between regulatory years and regulatory control periods as compared to the default position. This may include taking into account the actual revenues already collected by the DNSPs.<sup>21</sup>

The proposed rules also provide that should the 2015 determination be remade by the AER on or after 1 March 2018, the proposed rules specify that the total adjustment amount would be included in the building blocks in the subsequent regulatory control period.<sup>22</sup>

In addition, if at the conclusion of the judicial review process, the AER ceases to be under an obligation to remake the 2015 determination, the provisions of the proposed rules would still apply. This is because higher or lower revenues would have already been collected in the regulatory years as a result of the undertakings agreed between the DNSPs and AER (see section 2.2.2.).<sup>23</sup>

### **3.3 Variances specific to ActewAGL**

ActewAGL has proposed a similar mechanism to that of the NSW DNSPs. However, ActewAGL's proposed solution differs in certain respects by having regard to the different form of control mechanism applicable to ActewAGL (an average revenue cap control mechanism is applied).<sup>24</sup> It also addresses revenue recovery of transmission control services and metering services and adjusts for incentive mechanisms such as service target performance incentive scheme (STPIS).<sup>25</sup>

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21 NSW DNSPs rule change request, p. 15, Actew AGL rule change request p. 17.

22 NSW DNSPs rule change request, p. 18; Actew AGL rule change request p. 7.

23 NSW DNSPs rule change request, p. 2; Actew AGL rule change request p. 2.

24 Actew AGL rule change request p. 4.

25 Actew AGL rule change request p. 4.

### 3.4 Participant derogation or a wider rule change

The proponents consider that given their unique circumstances, a rule change that only applies to them is more appropriate than a wider rule change that would apply to all DNSPs. In addition they submit that the unique events which have prolonged the likely determination of annual revenues for the current regulatory period are not likely to be repeated.<sup>26</sup> These events include:

- the 2014-2015 “transitional” regulatory control period;
- the findings of the Tribunal in its merit review decision;
- the potential size of the difference in allowed revenues between the 2015 determination and the remade 2015 determination;
- the likely timeframe for AER to remake the determinations; and
- the AER’s application for judicial review.

According to the proponents, these events in aggregate only apply to the NSW DNSPs and ActewAGL and not all DNSPs operating in the NEM.<sup>27</sup>

As the rule change requests seek participant derogations for the NSW DNSPs and ActewAGL only, the Commission does not have the ability to extend the proposed rules to other DNSPs through this rule change process.

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<sup>26</sup> NSW DNSPs rule change request, p. 25; Actew AGL rule change request p. 9.

<sup>27</sup> NSW DNSPs rule change request, p. 25.

## 4 Assessment framework

The Commission's assessment of these rule change requests must consider whether the respective proposed rules promote the NEO.

The Commission can make changes to the NER that are different from the changes proposed in the rule change requests if the Commission is satisfied that its changes will, or are likely to, better promote the NEO than the changes proposed in the rule change requests.

From 1 July 2016, the NER, as amended from time to time, applies in the Northern Territory, subject to derogations set out in Regulations made under the Northern Territory legislation adopting the NEL.<sup>28</sup> Under those Regulations, only certain parts of the NER have been adopted in the Northern Territory.<sup>29</sup> As the rule change requests are seeking participant derogations for distribution networks in NSW and ACT, the Commission is not required to assess the proposed rule against additional elements required by the Northern Territory legislation.

### 4.1 Rule making test

Under 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.<sup>30</sup>

The NEO is:<sup>31</sup>

“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.”

Based on preliminary assessment of the rule change requests, the Commission considers that the most relevant aspects of the NEO are the efficient operation and use of electricity services with respect to the price of electricity.

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28 National Electricity (Northern Territory) (National Uniform Legislation) (Modifications) Regulations.

29 For the version of the NER that applies in the Northern Territory, refer to : [http://www.aemc.gov.au/Energy-Rules/National-electricity-rules/National-Electricity-Rules-\(Northern-Territory\)](http://www.aemc.gov.au/Energy-Rules/National-electricity-rules/National-Electricity-Rules-(Northern-Territory)).

30 Section 88 of the NEL.

31 Section 7 of the NEL.

## 4.2 Proposed assessment framework

The Commission proposes to assess if the rule change requests are likely to promote the NEO through consideration of the following criteria:

- **Is reducing price volatility in the long term interests of consumers?**

If there is a significant adjustment amount arising from a remade determination, consumers may experience a price variation of a large magnitude from one year to another. This price volatility may lead some consumers to make decisions on their investment and use of electricity services that, in the long term, are inefficient. If this is the case, minimising pricing volatility would benefit consumers.

- **If so, what is the best method to minimise price volatility?**

If it is decided that minimising price volatility is in the long term interests of consumers, the Commission will assess the best method for minimising pricing volatility.

- **Does this rule change align with the revenue and pricing principles?**

The Commission will also consider whether the proposed rules are consistent with revenue and pricing principles as set out in the NEL.<sup>32</sup> Specifically, the following revenue and pricing principles:

- A regulated network service provider should be provided with a reasonable opportunity to recover at least the efficient costs of providing direct control services;
- A regulated network service provider should be provided with effective incentives in order to promote economic efficiency with respect to its direct control services; and
- A price or charge for the provision of a direct control service should allow for a return commensurate with the regulatory and commercial risks involved in providing the service to which that price or charge relates.

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<sup>32</sup> Section 7A of the NEL.

## 5 Issues for consultation

This chapter identifies issues for consultation in relation to the proponents' rule change requests to recover revenue adjustments over two regulatory periods. The issues below are provided as a guideline for submissions. Stakeholders are encouraged to comment on these issues as well as any other aspect of the rule change requests or this paper, including the proposed assessment framework.

### 5.1 Costs and benefits of reducing pricing volatility

As discussed in previous sections, a remade determination for the 2014-2019 regulatory control period could lead to significant adjustments to the revenue that the proponents are entitled to receive for this period. The timing of the recovery of the adjustment amounts could have an impact on consumers' efficient investment and use of electricity services.

In the absence of a rule change, prices could rise significantly in the final year of the current regulatory control period followed by a decrease in the first year of the subsequent regulatory control period. Under these circumstances consumers may incorrectly make the assumption that the price increase in the final year of this regulatory control period will continue and act on this. If consumers make investments in alternative energy sources or technologies<sup>33</sup> based on a temporary price rise in an attempt to reduce their energy bill this could result in long term uneconomic outcomes. Ultimately consumers could be left with costly investments that no longer provide the anticipated benefit once the price falls again.

Conversely, if the adjustment amount is smoothed over two regulatory periods, the change in prices would be more gradual, and therefore create a less extreme price signal; however it would occur over a longer period.

#### **Question 1      Long term interests of consumers**

**a) To what extent would significant pricing volatility lead to inefficient usage and uneconomic investment decisions by consumers?**

**b) Would recovering any potential adjustments in revenue over two regulatory periods lead to more efficient usage and investment decisions by consumers?**

### 5.2 Mechanism for smoothing

As outlined in Chapter 3, the proponents have set out detailed revenue smoothing mechanisms in the rule change requests. However, the rule change requests also acknowledge the uncertainty around the distribution determinations and that there are a number of potential different scenarios that could eventuate.

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<sup>33</sup> Such as renewable energy, gas, batteries or load control.

To manage the uncertainty, the proposed rules include provisions that give both the network businesses and the AER the ability to make a different annual adjustment (a 'varied annual adjustment amount') than that derived from the smoothing mechanism if the resulting varied annual adjustment amount would better minimise pricing variations between regulatory years and regulatory control periods.<sup>34</sup>

**Question 2      Adjustment mechanism**

**What is the appropriate degree of detail and prescription for a mechanism to manage revenue smoothing under uncertain circumstances?**

Under the proposed rules, the network businesses would receive the potential annual adjustment amount and any expected subsequent adjustment amount in equivalent net present value (NPV) terms. In other words, in order to maintain the NPV of any revenue adjustments, a discount rate would be applied to the adjustment amounts to reflect the fact that the DNSPs are not receiving the revenue until a later date.<sup>35</sup>

Although the proponents state that any adjustment amount should be equivalent in NPV terms, they do not explicitly state how NPV will be calculated, for example what discount rate would be used. Instead, the approach to determining NPV would be at the AER's discretion, which is consistent with other provisions of the NER that do not prescribe how the AER is to determine NPV.

The appropriate discount rate to use was raised in the summary of stakeholders' key issues that was attached to the NSW DNSPs' rule change request. The NSW DNSPs stated that they consider that this issue would be determined as part of the post-tax revenue model supporting any remade decision of the AER.<sup>36</sup> Currently, the AER uses the weighted average cost of capital (WACC) for NPV calculations in the post-tax revenue model.

**Question 3      Net present value**

**Should the AER have discretion over how it calculates the NPV of the adjustment amounts, or should it be specified in the NER, if any rules are made?**

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<sup>34</sup> See NSW DNSPs rule change request, p. 15; Actew AGL rule change request p. 17.

<sup>35</sup> See NSW DNSPs rule change request, p. 13; Actew AGL rule change request p. 17.

<sup>36</sup> See NSW DNSPs rule change request, p. 11.

## **6 Lodging a submission**

The Commission has published a notice under s. 95 of the NEL for the rule change requests inviting written submission. Submissions are to be lodged online or by mail by 15 December 2016 in accordance with the following requirements.

Where practicable, submissions should be prepared in accordance with the Commission's Guidelines for making written submissions on rule change requests.<sup>37</sup> The Commission publishes all submissions on its website subject to a claim of confidentiality.

All enquiries on this project should be addressed to Rachel Armstrong on (02) 8296 7800.

### **6.1 Lodging a submission electronically**

Electronic submissions must be lodged online via the Commission's website, [www.aemc.gov.au](http://www.aemc.gov.au), using the "lodge a submission" function and selecting the relevant project reference code as follows:

ERC0210 - Participant derogation - NSW DNSPs revenue smoothing

ERC0216 - Participant derogation - ACT DNSPs revenue smoothing

Separate submissions do not have to be made in respect of each of the rule change requests. Comments made in submissions that refer to both project codes and that do not indicate that the comment is made in respect of only one of the rule changes requests, will be treated as comments that apply to both requests.

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

### **6.2 Lodging a submission by mail**

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated. The submission should be sent by mail to:

Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

The envelope must be clearly marked with the project reference code ERC0210/ERC0216.

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<sup>37</sup> This guideline is available on the Commission's website [www.aemc.gov.au](http://www.aemc.gov.au)

## Abbreviations

AEMC	Australian Energy Market Commission
Commission	See AEMC
NEL	National Electricity Law
NEO	national electricity objective
NER	National Electricity Rules
NPV	net present value
Proponents	NSW and ACT DNSPs