



Australian Energy Market Commission

Rule Determination

National Electricity Amendment (WACC, alignment of reviews) Rule 2008

Rule Proponent
Australian Energy Regulator

26 June 2008

Signed: 

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Chairman

For and on behalf of
Australian Energy Market Commission

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About the AEMC

The Council of Australian Governments, through its Ministerial Council on Energy, 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 policy advice covering the National Electricity Market. It is a statutory authority. 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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Abbreviations

ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
Commission	see AEMC
ENA	Energy Networks Association
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
Rule Change Proposal	Australian Energy Regulator, <i>Request for Changes to the National Electricity Rules – Alignment of the AER’s Review of the WACC Parameters for Transmission and Distribution</i> , 14 April 2008
Rules	National Electricity Rules
SCO	Standing Committee of Officials
WACC	Weighted Average Cost of Capital

1 Australian Energy Regulator's Rule Change Proposal

1.1 Background

On 14 April 2008, the Australian Energy Regulator (AER) lodged a Rule change proposal with the Commission entitled 'Alignment of the AER's Review of the WACC Parameters for Transmission and Distribution' (Rule Change Proposal).¹

The objective of the Rule Change Proposal is to allow the AER to undertake simultaneous reviews of the rate of return and taxation parameters applying to transmission and distribution networks, as required by clauses 6A.6.2(f), 6A.6.4(b) and 6.5.4(a). To enable this to occur, the AER has proposed amending the National Electricity Rules (Rules) so that the review period for transmission networks is brought into alignment with the review period specified for distribution networks and that the two reviews be completed by 31 March 2009.

The AER has submitted that the Rule Change Proposal is non-controversial and has therefore requested that the Rule making process be expedited in accordance with section 96 of the National Electricity Law (NEL).

1.2 Problem to be addressed by the Rule Change

Clauses 6A.6.2(f) and 6A.6.4(b) of the Rules require the AER to undertake a review of a number of the parameters used in the derivation of the rate of return and taxation allowances for transmission network service providers. In accordance with clauses 6A.6.2(g) and 6A.6.4(c) the first review must be initiated on 1 July 2009 and subsequent reviews are to be undertaken every five years thereafter.

Similar rate of return and taxation parameter review provisions have been incorporated into the recently implemented *Economic Regulation of Distribution Service Rules* (Distribution Rules). The Distribution Rules are contained in chapter 6 of the Rules. The timing of the first review, however, differs from that adopted for transmission networks in chapter 6A. Specifically, clause 6.5.4(b) requires the AER to complete its first review by 31 March 2009.

The Commission understands that at the time of drafting the Distribution Rules, the Ministerial Council on Energy (MCE) Standing Committee of Officials (SCO) had contemplated aligning the transmission and distribution reviews. However, to ensure that the review was completed in advance of the South Australian and Queensland distribution network determinations, the SCO decided that the review should be completed by 31 March 2009.² Although an earlier review period was adopted for distribution, the MCE's 13 December 2007 Communiqué noted that there

¹ Australian Energy Regulator, *Request for Changes to the National Electricity Rules – Alignment of the AER's Review of the WACC Parameters for Transmission and Distribution* (Rule Change Proposal), 14 April 2008.

² Ministerial Council on Energy Communiqué, Perth 13 December 2007, p 2.

may be some “merit in aligning the timing of the equivalent transmission review”³ but indicated that this was an issue that would need to be considered by the Commission.

In a similar manner to the MCE, the AER is of the view that there would be some benefit from aligning the timing of the two reviews subject to the caveat that the distribution review is completed in advance of the AER’s consideration of the South Australian and Queensland resets. The principal benefits cited by the AER in this context are that undertaking the two reviews simultaneously will:

- allow all interested parties to contribute to the consultation process; and
- ensure that issues common to both transmission and distribution are treated in a consistent manner.

1.3 Proponent’s proposed solution

To bring the two reviews into alignment while also ensuring that the distribution review is completed in advance of the South Australian and Queensland reviews, the AER has suggested:

- bringing forward the transmission review period from the 1 July 2009 initiation date currently specified in Rules 6A.6.2(g) and 6A.6.4(c); and
- requiring the two reviews to be completed by 31 March 2009.

Specifically, the AER has proposed amending Rules 6A.6.2(g) and 6A.6.4(c) in the following manner:

clause 6A.6.2(g): The AER must ~~initiate~~ conclude the first review ~~on 1 July 2009~~ by 31 March 2009 and every five years thereafter.

clause 6A.6.4(c): The AER must ~~initiate~~ conclude the first review ~~on 1 July 2009~~ by 31 March 2009 and every five years thereafter.⁴

The AER has submitted that bringing forward the review period for transmission networks will neither:

- impose any additional costs on transmission network service providers; nor
- adversely affect any transmission network service provider’s revenue proposal since there are no transmission network service providers that are due to submit revenue proposals during the period 31 March 2009 and 31 May 2011.⁵

³ Ministerial Council on Energy Communiqué, Perth 13 December 2007, p 2.

⁴ Rule Change Proposal, p 6.

⁵ Rule Change Proposal , p 4-5.

1.4 Consultation

On 15 May 2008, the Commission published a notice under section 95 of the NEL advising of its intention to commence the Rule change process and initial consultation on the Rule Change Proposal.

The Commission considered that the Rule Change Proposal was a request for a non-controversial rule and, accordingly, intended to expedite the Rule Change Proposal under section 96 of the NEL, subject to any written objections. The Commission took the view that the Rule Change Proposal was unlikely to have a significant effect on the National Electricity Market as the Rule Change Proposal sought to improve the clarity of Weighted Average Cost of Capital (WACC) parameter reviews.

The closing date for written objections in relation to expediting the Rule Change Proposal under section 96 of the NEL was 29 May 2008. No written objections were received.

The closing date for submissions on the Rule Change Proposal was 13 June 2008. The Commission received four submissions in response to the Rule Change Proposal from:

- Energy Networks Association (ENA);⁶
- Energex;⁷
- TransGrid;⁸ and
- EnergyAustralia.⁹

The submissions were supportive of the Rule Change Proposal. The ENA's submission supported the proposed alignment of the transmission and distribution rate of return reviews and noted that the alignment of reviews would result in a more efficient, robust and cost-effective review process. Energex expressed a similar view. The ENA also noted that if the Rule Change Proposal were not approved then the AER would be required to undertake a 'duplicative, poorly sequenced process examining what are in many cases common issues of parameter establishment and detailed methodology'.¹⁰

⁶ Energy Networks Association, *AEMC Rule Change – Alignment of the AER's Review of WACC Parameters for Transmission and Distribution and Technical Drafting Amendments*, 10 June 2008.

⁷ Energex, *AEMC Rule Change – Weighted Average Cost of Capital*, 13 June 2008.

⁸ TransGrid, *Submission – AER Request for Changes to the NEL - WACC Parameters: technical drafting issues*, 13 June 2008.

⁹ EnergyAustralia, *Submission on AER rule request for WACC review*, 13 June 2008.

¹⁰ ENA, p. 1.

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2 Rule Determination

2.1 Commission's Determination

In accordance with section 102 of the NEL the Commission made and published this Rule determination. In accordance with section 103 of the NEL the Commission determined to make the *National Electricity Amendment (WACC, Alignment of Reviews) Rule 2008 No 4* (Rule as Made).

The Rule as Made will commence on 1 July 2008.

The Rule as Made, which is different from the proposed Rule in the Rule Change Proposal is published with this determination.¹¹

2.2 Commission's considerations

In coming to its decision in favour of the Rule as Made, the Commission has taken into account:

- the Commission's powers under the NEL to make the Rule as Made;
- the Rule Change Proposal, including the provisions originally put forward by the AER;
- the submissions received from ENA, TransGrid, EnergyAustralia and Energex; and
- the Commission's analysis as to the ways in which the Rule Change Proposal will, or is likely to, contribute to the NEO so that the rule making test is satisfied.

For the reasons set out in section 3 the Rule As Made satisfies the Rule making test. In brief the Commission considers that the Rule as Made will, or is likely to, contribute to the achievement of the National Electricity Objective (NEO) because, in addition to providing regulatory certainty, it provides greater clarity about when reviews subsequent to the first review will be undertaken.

The key differences between the AER proposed Rule and the Rule as Made are explained in the analysis in section 3.

¹¹ See section 103(3) of the NEL. It provides, amongst other things, that the Rule that is made need not be the same as the draft of the proposed Rule to which a notice under section 95 relates.

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3 Commission's assessment against NEL criteria

3.1 Methodology

This section sets out the Commission's reasons for its Rule determination. In assessing any proposed Rule change against the NEL criteria, the first step is to consider the relevant counterfactual arrangements to which the change is being compared. In the present case, the appropriate counterfactual would be the continuation of present arrangements under which the AER would be undertaking a review of the rate of return and taxation parameters applying to distribution networks, to be concluded by 31 March 2009 (as required by clause 6.5.4(b)). Then, as required by clauses 6A.6.2(f) and 6A.6.4(b) the AER would be required to initiate the first review of these parameters applying to transmission networks on 1 July 2009.

3.2 Commission's power to make the Rule

The Commission is satisfied that the Rule as Made falls within the subject matter for which the Commission may make Rules, as set out in section 34 of the NEL and schedule 1 to the NEL. The Rule as Made falls within the matters set out in section 34 of the NEL as it relates to the activities of persons participating in the National Electricity Market (NEM) or involved in the operation of the NEM. Further, item 33 of schedule 1 to the NEL covers reviews by or on behalf of the AER, amongst other entities.

3.3 Rule making test and the National Electricity Objective

The Rule making test provides 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.¹² The overarching objective of the NEL 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:

- price, quality, safety, reliability and security of supply of electricity; and
- the reliability, safety and security of the national electricity system.¹³

The NEO is founded on the concepts of economic efficiency (including productive, allocative and dynamic dimensions of efficiency), good regulatory practice (which refers to the means by which regulatory arrangements are designed and operated) as well as reliability, safety and security priorities.

In the Rule Change Proposal the AER explained why it considered that its proposed Rule would promote the NEO. According to the AER:

¹² See section 88(1) of the NEL.

¹³ See section 7 of the NEL.

‘...the proposed Rule change will contribute to the NEO by promoting efficient investment in electricity networks across the NEM. In particular, alignment of transmission and distribution WACC reviews will enhance regulatory certainty by:

- Ensuring consistency in the AER’s approach and treatment of WACC issues (where appropriate) for the electricity network sector as a whole, and
- Allowing interested parties to contribute to the consultation process for both industries simultaneously’.¹⁴

The ENA was also of the view that the Rule Change Proposal would promote the NEO. Specifically, the ENA stated that:

‘...rule changes promote the National Electricity Law objective by making regulatory process associated with establishing important cost of capital parameters and methodologies efficient...’¹⁵

The Commission agrees that consistency in approach to the review of the concepts around the economic regulation of transmission and distribution networks will promote efficient investment in electricity services and will provide some degree of regulatory certainty for the benefit of both network owners and consumers. The simplest way to ensure consistency is to conduct the reviews simultaneously. Therefore, the Commission considers the Rule as Made will promote the NEO and, accordingly, satisfies the Rule making test. The Commission’s more detailed assessment is set out below.

As the Rule Change Proposal:

- is not related to specifying direct control network services or negotiated network services, section 88A of the NEL (form of regulation factors) is not relevant to this analysis; and
- does not fall within items 15-24 and 25-26J of Schedule 1 to the NEL, section 88B of the NEL (revenue and pricing principles) is not relevant to this analysis.

3.4 Commission’s assessment

The Commission accepts that there is some benefit to the AER undertaking both the transmission and distribution reviews concurrently and completing the distribution review in advance of the South Australian and Queensland distribution network determinations. The Commission has therefore largely accepted the Rule Change Proposal which will entail bringing forward the transmission review period and

¹⁴ Rule Change Proposal, p 4

¹⁵ ENA, AEMC Rule Change – Alignment of the AER’s Review of WACC Parameters for Transmission and Distribution and Technical Drafting Amendments, 10 June 2008, pp. 1-2.

completing both the distribution and transmission parameter reviews by 31 March 2009.

The Commission's only concern with the AER's proposed Rule is that it creates some uncertainty around the timing of reviews subsequent to the first review. To avoid this issue some additional words should be included which confirm that further reviews should be completed by 31 March every five years after the first review is completed. A five year period is consistent with the minimum five year duration of transmission determinations.¹⁶ Clarification of this issue is important so that transmission network service providers know when regulatory proposals will be subject to revised parameters. Also, it provides certainty to the AER that it must complete the parameter reviews for transmission by this date.

Incorporating this change would result in the following amendments to Chapter 6A of the Rules:

Rule 6A.6.2(g): The AER must ~~initiate~~ conclude the first review ~~on 1 July 2009~~ by 31 March 2009 and conclude subsequent reviews at intervals of every five years thereafter.

Rule 6A.6.4(c): The AER must ~~initiate~~ conclude the first review ~~on 1 July 2009~~ by 31 March 2009 and conclude subsequent reviews at intervals of every five years thereafter.

Having applied the Rule making test, the Commission is satisfied that this final Rule determination is likely to contribute to the attainment of the NEO. Specifically, the Commission is satisfied that affording the AER the opportunity to adopt, where appropriate, a consistent approach to rate of return and taxation issues across transmission and distribution, will enhance both the efficiency and consistency of the regulatory practice in this area over the long term and in so doing promote regulatory certainty.

¹⁶ Note, however, that under clause 6.5.4(b) subsequent reviews for distribution parameters could take place earlier than five years following completion of the first review.

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