



Australian Energy Market Commission

CONSULTATION PAPER

National Electricity Amendment (Economic regulation of network service providers) Rule 2011

National Gas Amendment (Price and revenue regulation of gas services) Rule 2011

Rule Proponent(s)

Australian Energy Regulator

20 October 2011

RULE
CHANGE

Inquiries

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

E: aemc@aemc.gov.au

T: (02) 8296 7800

F: (02) 8296 7899

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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. The AEMC has two principal functions. We make and amend the national electricity and gas rules, and we conduct independent reviews of the energy markets for the MCE.

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1 Introduction

On 29 September 2011, the Australian Energy Regulator (AER) submitted two Rule change requests to the Australian Energy Market Commission (AEMC or Commission) in relation to the economic regulation of electricity and gas transmission and distribution businesses.

This Consultation Paper has been prepared by the staff of the AEMC to facilitate public consultation on the Rule change proposal and does not represent the views of the AEMC or any individual Commissioner of the AEMC.

This paper:

- sets out a summary of the two Rule change requests submitted to the AEMC by the AER;
- describes the process the AEMC intends to follow in dealing with the Rule change requests;
- seeks comments on each aspect of the AER's Rule change requests and identifies a number of overall themes that cover the different aspects of those requests and on which the AEMC would welcome views; and
- outlines the process for making submissions.

2 Details of the Rule Change Request

The AER has submitted two Rule change requests to the AEMC. One relates to economic regulation of electricity transmission and distribution businesses, and one to the determination of the rate of return for gas network businesses.

The Rule change requests from the AER propose to address the deficiencies in the framework for economic regulation of electricity network businesses identified by it, as well as to improve the rate of return provisions in the corresponding framework for gas businesses. In particular, the Rule change requests seek to address:

- **the capital and operating expenditure framework in electricity** - this includes the restrictions on when the AER may reject an electricity network business's capital or operating expenditure forecast and the requirement that the regulator must accept a forecast if it reasonably reflects certain criteria listed in the Rules. The obligation on the AER to base any substitute on the original regulatory proposal is also covered;
- **the incentive arrangements in electricity** - in particular, the requests address the requirement in the electricity framework that all actual capital expenditure incurred within a regulatory control period must be automatically rolled into the asset base at the start of the next period. Instead, the AER proposes that only a part of this could be rolled into the asset base for the next period;
- **the cost of capital provisions in both electricity and gas** - the Rule change requests consider the different arrangements for cost of capital in electricity distribution, electricity transmission and gas, and propose an approach which most closely aligns with electricity transmission, that is, the outcomes of the periodic cost of capital reviews cannot be departed from in a subsequent regulatory determination. The AER also proposes that the methodology for setting the debt risk premium should be included in the periodic cost of capital reviews; and
- **the efficiency of the regulatory process** - the requests address areas where the AER considers the regulatory process could be improved to allow stakeholders to engage more effectively in the process.

As the Rule change requests set out the AER's proposals in detail we have only summarised the proposals at a high level in this Consultation Paper.

The Rule change requests include proposed Rules. These Rule change requests can be found on the AEMC's website.

3 Rule Change Process

The AEMC has determined that the Rule change requests meet the statutory criteria set out in section 94 of the National Electricity Law (NEL) and section 301 of the National Gas Law (NGL), including that the Commission has the power to make the proposed Rules.

It is important to note that commencing the Rule change process does not necessarily indicate that the Commission intends to make the proposed Rules. The possible outcomes of the process are that the Commission could:

- make the Rules proposed by the AER;
- make Rules different to those proposed (including more preferred Rules); or
- not make any Rule.

Due to the complex nature of these Rule change requests, the AEMC has also determined under section 107 of the NEL and section 317 of the NGL to extend the length of the Rule change process in this case. The process will also include an extra stage of consultation compared to the standard Rule change process.

At a high level, the Rule change process will be as follows:

- Following the consultation on the Rule change requests that commences with the initiation of the process and the publication of this Consultation Paper, the AEMC will publish a Directions Paper. The Directions Paper will set out the AEMC's preliminary views on the Rule change requests;
- Stakeholders will have the opportunity to make submissions on the Directions Paper in a second round of consultation;
- The Commission will then prepare and publish a Draft Determination, along with any draft Rule;
- In the third round of consultation stakeholders may make submissions on this Draft Determination and any draft Rule;
- Following consideration of these submissions the Commission will prepare and publish a Final Determination and final Rule

This process is expected to take approximately one year.

This process is set out in more detail, with indicative dates, in the timetable in Appendix A.

4 Forums

As part of the first and second rounds of consultation on the Rule change requests, the AEMC is proposing to hold a series of forums for discussion on the Rule change requests.

In the first round of consultation the AEMC will conduct a Public Forum, to be held in Brisbane on 23 November 2011. At the Public Forum the AER will outline its Rule change requests, the AEMC will describe its process, and representatives of stakeholder groups will be given the opportunity to present their views on the AER's Rule change requests.

In the first round of consultation the AEMC will also hold separate meetings with other stakeholders, to be held in selected cities.

The AEMC may hold similar forums and meetings in the second round of consultation.

5 Issues for Consultation

We would encourage respondents to set out their views separately on each aspect of the AER's Rule change requests. This includes whether stakeholders agree with the problem identified by the AER, the Rule changes proposed, the costs and benefits of making the Rule changes identified by the AER, and the AER's justification for why the Rule change will better meet the National Electricity Objective (NEO) or National Gas Objective (NGO). We would also encourage stakeholders wherever possible to provide quantitative analysis or data which support any submissions made.

On the basis that it is the Economic Regulation Authority, rather than the AER, which undertakes economic regulation of gas in Western Australia the AEMC is also particularly interested in stakeholder views of the impact in Western Australia of the proposed changes to the NGR.

In addition to each aspect of the Rule Change proposal, we have identified a number of themes for consultation that appear to be relevant to the Rule change requests as an overall package.

The themes outlined below are provided for guidance. Stakeholders are encouraged to comment on these issues as well as any other aspect of the Rule change requests:

- **The problem** - Do you agree with the extent of the problems with the framework for economic regulation of electricity and gas networks as characterised by the AER? We would also welcome views and analysis on the effectiveness of the current rules as they have been applied over the last five years.
- **Prescription and discretion** - Rules that are more prescriptive set out more detail around the how the AER makes its decisions. Rules that allow for more discretion give the AER more scope to decide for itself how decisions are to be made. Have the proposed Rules achieved the right balance between prescription and discretion?
- **AER's use of its discretion** - Among other things, the proposed Rules would give the AER greater discretion to assess and respond to capital and operating expenditure proposals. Could the AER instead achieve the same outcomes through greater use of the discretions it currently has, avoiding the need for expanding these discretions?
- **The solution** - On the basis of the problems raised by the AER, are there any more preferable solutions to those problems? Please note that the AEMC may only implement Rule changes that respond to the problems raised by the AER, and it may not consider proposed changes that respond to other problems raised in submissions.

6 Lodging Submissions

The Commission has published notices under section 95 of the NEL and section 303 of the NGL for these Rule change requests inviting written submissions. Submissions are to be lodged online or by mail by 8 December 2011 in accordance with the requirements set out below. The AEMC is expecting a significant number of submissions so in order to be given full consideration submissions must be received by the close of the consultation period. **Submissions that are received after this time may not be given full weight.**

Stakeholders are encouraged to raise any specific comment as early as possible in the Rule change process, to enable the AEMC to give it the fullest possible consideration. Further, to the extent a submission refers to separate materials (such as reports or studies) these should be included in the submissions or an internet link provided. The AEMC is particularly interested to see any quantitative analysis which would justify conclusions reached in submissions.

Where practicable, submissions should be prepared in accordance with the Commission's Guidelines for making written submissions on Rule change requests. The Commission publishes all submissions on its website subject to a claim of confidentiality. Comments made in the forums described in section 4 above will not be treated as submissions although the AEMC will publish a summary of the discussions at each forum on our website.

All enquiries on this project should be addressed to Richard Khoe 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, using the "lodge a submission" function and selecting the project reference code ["ERC0134"] or ["GRC0011"]. In the body of the submission it should clearly indicate whether it is being made in respect of project ERC0134 (electricity), project GRC0011 (gas) or both. The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

Upon receipt of the electronic submission, the Commission will issue a confirmation email. If this confirmation email is not received within 3 business days, it is the submitter's responsibility to ensure the submission has been delivered successfully.

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

Or by Fax to (02) 8296 7899.

The envelope must be clearly marked with a project reference code: either ERC0134 (electricity) or GRC0011 (gas) or both.

Except in circumstances where the submission has been received electronically, upon receipt of the hardcopy submission the Commission will issue a confirmation letter.

If this confirmation letter is not received within 3 business days, it is the submitter's responsibility to ensure successful delivery of the submission has occurred.

Abbreviations

AEMC	Australian Energy Market Commission
Commission	See AEMC
NEL	National Electricity Law
NEO	National Electricity Objective
NGL	National Gas Law
NGO	National Gas Objective

Appendix A Indicative Timetable

Milestone	Date
AER's Rule change request received	29 September 2011
AEMC issues notices to commence Rule change process and invites first round submissions from stakeholders under section 95 of the NEL and section 303 of the NGL	20 October 2011
AEMC issues notices to extend the time period for making the draft Rule determinations under section 107 of the NEL and section 317 of the NGL	20 October 2011
First round consultation - public forum in Brisbane	23 November 2011
Submissions close on first round consultation	8 December 2011
Second round consultation - AEMC will release a Directions Paper setting out its initial thinking on the Rule change proposals	Late February 2012
Second round consultation – public forum in Brisbane, Sydney, Melbourne or Adelaide (to be confirmed)	Early March 2012
Submissions close on Directions Paper	Early April 2012
Release draft Rule determinations	By 26 July 2012
Submissions on draft Rule determinations close (at least 6 weeks from release of draft Rule determination)	6 September 2012
Release final Rule determinations by (within 6 weeks from close of submissions on draft Rule determinations)	By 15 October 2012