



Australian Energy Market Commission

RULE DETERMINATION

National Electricity Amendment (Rate of Return Guidelines Review) Rule 2016

National Gas Amendment (Rate of Return Guidelines Review) Rule 2016

Proponent

Australian Energy Regulator

13 October 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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Summary

The Australian Energy Market Commission (the Commission) has made final rules under the National Electricity Rules (NER) and National Gas Rules (NGR) to extend the timeframe of the first review of the Rate of Return Guideline from three years to five years. This requires the Australian Energy Regulator (AER) and Economic Regulation Authority (ERA) of Western Australia to review their Rate of Return Guidelines by no later than 17 December 2018. This rule has been made in response to a rule change request submitted by the AER.

The final rule under the NER also includes a specific transitional arrangement to provide additional regulatory certainty for a number of service providers. These service providers are TasNetworks, Power and Water Corporation, Ausgrid, Endeavour Energy, Essential Energy, and ActewAGL.

The Commission determined that it should make the rules as proposed by the AER, as it considers they will, or are likely to, contribute to the achievement of the national electricity and national gas objectives. This is because the rules will promote efficient investment in electricity and gas services for the long term interests of consumers.

In extending the time to review the Rate of Return Guideline, the rules provide an opportunity for the outcomes of the Federal Court of Australia decisions related to the New South Wales and Australian Capital Territory limited merits review processes to be taken into account in the next Guideline review process. Including relevant, up-to-date information in the Guideline has the potential to reduce regulatory costs, and lower the risk of (and costs associated with) reviews of future regulatory determinations and decisions.

The AER may become the economic regulator for Western Australian gas pipeline operators in 2018 as part of reforms currently being progressed by the Government of Western Australia. However, this transfer is not yet confirmed. If the proposed transfer does not occur, the final rule will require the ERA to review its Rate of Return Guideline by 18 December 2018.

The Commission adopted an expedited process in considering this rule change request as it considered that the proposed rules were unlikely to have a significant impact on the National Electricity Market, gas market, or the regulation of pipeline services. No objections to using this process were received. The Commission also extended the time between the publication of the consultation paper and the final determination by two weeks to allow more time to consider submissions to the consultation paper. Stakeholders provided 13 written submissions to this process.

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1 The rule change request

1.1 The AER's rule change request

On 7 June 2016, the Australian Energy Regulator (AER) submitted a rule change request to the Australian Energy Market Commission (AEMC or Commission) seeking to extend the deadline to review the current Rate of Return Guidelines (the Guideline) under both the NER and the NGR.¹ The Guideline was first published on 17 December 2013, and the proposed rule change would extend the deadline of the first review by two years, from 17 December 2016 to 17 December 2018.

1.2 Relevant background

The Guideline plays an integral role in the AER's economic regulatory decision making processes. It provides information specifying the approach that the AER proposes to use in determining the allowed rate of return as part of the regulatory determination and access arrangement decision processes for electricity network and gas transmission and distribution pipeline service providers (service providers).

The Guideline contains information about how the AER proposes to estimate the allowed rate of return, including how its methodologies will result in determinations that are consistent with the allowed rate of return objective.² The Guideline must include the estimation methods, financial models, market data and other evidence the AER proposes to take into account when determining the return on equity, return on debt, and the value of imputation credits.

The AEMC's 2012 Economic Regulation of Network Service Providers Rule established the Guideline and its application to both gas and electricity service providers. Amendments made to Chapters 6 and 6A of the NER and rule 87 of the NGR under that rule required the AER to periodically publish the Guideline and to consult with stakeholders on its contents in doing so. The AER is required to review the Guideline at intervals of no greater than three years.³

The Guideline is not binding and service providers and the AER may depart from the Guideline, subject to providing reasons for such departure.⁴

The AER is also able to amend or replace the Guideline at any time provided all requirements for consultation are met⁵ and that it is reviewed at intervals not

¹ Clauses 6.5.2(m) and 6A.6.2(m) of the National Electricity Rules (NER) and rule 87(13) of the National Gas Rules (NGR) require the AER to make and publish the Rate of Return Guidelines.

² Clauses 6.5.2(c) and 6A.6.2(c) of the NER and rule 87(3) of the NGR specify that the allowed rate of return objective is that the rate of return for a service provider is to be commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk as that which applies to the service provider in respect of the provision of standard control services (in the case of the NER) and reference services (in the case of the NGR).

³ This is set out in clauses 6.5.2(p)(1) and 6A.6.2(p)(1) of the NER and rule 87(16)(a) of the NGR.

⁴ The flexibility for the AER to depart from the Guideline is set out in clauses 6.2.8(c) and s. 6A.2.3(c) of the NER and rule 87(18) of the NGR. The flexibility for service providers to depart from the Guideline is set out in Schedules 6.1.3(9) and 6A.1.3 of NER and rule 72(1)(g) of NGR.

exceeding three years. This allows the AER to account for changing circumstances with respect to the external environment and in relation to information that affects how the allowable rate of return should be determined. It also provides the AER some flexibility to determine a suitable revision schedule that can accommodate the business needs of the service providers in the regulatory determination and access arrangement processes.

The initial publication date of the Guideline was 17 December 2013. Accordingly, the first review of the Guideline is required to be undertaken by no later than 17 December 2016.

1.3 Rationale for the rule change request

The AER stated in its rule change request that key elements of the current Guideline are in contention before the Australian Competition Tribunal and Federal Court of Australia (ACT and FCA) and that a final resolution of these proceedings is unlikely to occur before 17 December 2016.⁶ Accordingly, the AER considered that there is ‘no value’ in commencing a review of the Guideline before the FCA decisions and related processes are complete as the outcomes of these proceedings may trigger a change in the AER’s approach as to how the allowed rate of return is determined.⁷

The AER also noted that the proposed timing of the revised Guideline (17 December 2018) is likely to occur during a period where some service providers would be in the midst of their regulatory determination processes.

1.4 Solution proposed in the rule change request

The AER has sought to extend the review deadline of the next Guideline from 17 December 2016 to 17 December 2018. This requires amending the NER and NGR to extend the first (initial) review period from the current three years, to five years. It is proposed that subsequent reviews of the Guideline would continue on a three year cycle. The proposed deadline anticipates that the FCA decisions and related processes would have concluded, and that the AER would then have sufficient time to develop, consult and publish a revised Guideline.

The AER stated that the rule change request meets the national electricity objective (NEO) and the national gas objective (NGO) because the proposed rules would allow the AER to fully consider the outcomes from the FCA and related processes prior to revising the Guideline. In its view, this will improve the predictability of outcomes relating to rate of return issues. The AER considered that this is likely to materially benefit the long term interest of consumers.

⁵ This is set out in clauses 6.2.8(e) and 6A.2.3(e) of the NER and rule 87(17) of the NGR.

⁶ All New South Wales and Australian Capital Territory electricity distribution service providers applied for merits review of the AER’s final revenue determinations. The Australian Competition Tribunal’s merits review decisions on 26 February 2016 required the AER to remake its final determinations. The AER has applied for judicial review of the Tribunal’s decisions to the Federal Court of Australia.

⁷ AER, Request for a rule change, 7 June 2016, p. 2.

The AER also proposed that the rule change request be treated as non-controversial on the basis that the 'proposed rule change is unlikely to have a significant effect on the energy market'.⁸

The AER also proposed to develop a structure and schedule to consider the application of the revised Guideline on any of its regulatory decision making processes that are underway at the time the revised Guideline is published. It also stated that all stakeholders would have reasonable opportunity to discuss how the Guideline may impact on such decision making processes.

1.5 Timing issue and potential transitional provisions

The consultation paper identified that the proposed Guideline review deadline (17 December 2018) may be problematic for six affected service providers (TasNetworks, Power and Water, Ausgrid, Endeavour Energy, Essential Energy, and ActewAGL – the affected service providers). The AER's regulatory determination forward schedule⁹ indicated that the earliest an affected service provider could submit a revised regulatory proposal would be 30 November 2018.¹⁰ This means that the revised Guideline would be likely to be published near the time that revised proposals are due. Given that these two dates are flexible, scenarios could arise where the revised Guideline is published before an affected service provider has had sufficient time to consider the new information in its revised regulatory proposal submission.¹¹

In preparing the consultation paper, the Commission understood that certain stakeholders had concerns regarding this timing issue as it is unclear if the current 2013 Guideline, or the revised Guideline, should apply to their revised regulatory proposal. If the revised Guideline were to apply, the affected service providers would be unlikely to have had sufficient time to consider it and decide on whether and how to either incorporate or depart from the Guideline in their revised regulatory proposals.

In order to address this timing issue, the Commission considered that transitional arrangements may be required to accompany the AER's proposed amendments to the NER and NGR. The purpose of such transitional provisions would be to promote regulatory certainty to the affected service providers and other stakeholders by specifying the arrangements from the outset.

⁸ AER, Request for a rule change, 7 June 2016, p. 1.

⁹ Appendix C is based on the 'AER 7 year regulatory determination calendar 2015-2022' (June 2016 version) found at: <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements>, accessed on 2 August 2016. This attachment superimposes the current (yellow) and proposed (green) Guideline review deadline dates. The gas service provider schedule has not been included as there are no conflicts with gas service providers at the proposed review deadline.

¹⁰ The AER's forward schedule provides indicates that it will release its draft determinations for the affected service providers on 31 September 2018. Service providers must wait at least 45 business days before submitting a revised regulatory proposal. Therefore, the earliest that affected service providers can submit their revised regulatory proposals is 30 November 2018.

¹¹ The revised regulatory proposal is the last point at which a service provider can respond to the AER's draft determination on the service providers revenue proposal.

The Commission's initial view was that if transitional provisions are necessary, the most appropriate approach would be for the provisions to specify that the current 2013 Guideline would apply to the 2018 regulatory determination processes of the affected service providers rather than a newly revised Guideline. Additionally, such transitional provisions would only apply in respect of the first review of the Guideline, and would not prevent affected service providers, or the AER, from being able to depart from the 2013 Guideline.¹²

The ERA is currently the economic regulator for gas pipelines in Western Australia. The NGR requires the ERA to complete the first review of its Rate of Return Guideline by 17 December 2016. However, the NGR provides that this date may be extended in certain circumstances and the ERA has deferred the first review of its Rate of Return Guidelines due to the potential transfer of regulatory function to the AER.¹³ The AER may become the economic regulator for Western Australian gas pipeline operators as part of Western Australia's 'Transfer of Regulatory Functions Project', which is discussed in more detail in section 2.2.2.

The transition of functions to the AER is proposed to commence from July 2018. If the transfer proceeds in accordance with the proposed timeframes, the AER's Rate of Return Guideline is expected to apply to Western Australian service providers in their future revenue and access determinations. If the transition does not occur by this time, the ERA will be required to undertake a review of its Rate of Return Guideline in accordance with the NGR.

1.6 Commencement of rule making process

On 18 August 2016, the Commission published a notice under s. 95 of the National Electricity Law (NEL) and s. 303 of the National Gas Law (NGL) advising of its intention to commence the rule making process and the first round of consultation. A consultation paper identifying specific issues for consultation was also published. Submissions closed on 15 September 2016.

The Commission received 13 submissions.¹⁴ Issues raised in submissions are discussed Chapter 4 and 5 of this final rule determination. A summary of other issues raised in submissions, and the Commission's response to each issue, is contained in Appendix A.

The Commission accepted that the rule change request was a request for a non-controversial rule. Accordingly, it commenced the rule change process as an expedited process under s. 96 of the NEL and s. 304 of the NGL, subject to any written requests not to do so. The closing date for receipt of written objections was 1 September 2016.

No objections were received. Accordingly, the rule change request was considered under an expedited process. The Commission also extended the time between the

12 Those parties that wish to depart from the relevant Guideline would still be able to do so, subject to providing reasons for such departure.

13 Information on the Transfer of Regulatory Functions Project for Western Australia can be found at https://www.finance.wa.gov.au/cms/Public_Utility_Office/Electricity_Market_Review/Transfer_of_Regulatory_Functions.aspx

14 www.aemc.gov.au

publication of the consultation paper and the final determination by two weeks to allow more time to consider submissions to the consultation paper.

2 Final rule determination

This chapter outlines:

- the Commission's rule making test for changes to the NER and NGR;
- the assessment framework used by the Commission in considering the rule change request; and
- the Commission's consideration of the final rule against the NEO and NGO.

Further information on the legal requirements for making this final rule determination is set out in Appendix B.

2.1 Final rule

In accordance with ss. 102 and 103 of the NEL and ss. 311 and 313 of the NGL, the Commission has made this final rule determination and final rules in relation to the rule change request.

The Commission has made the final rules as proposed by the proponent. In addition, the Commission has included transitional arrangements in the NER in order to provide regulatory certainty for the six affected service providers.

In brief, the final rules:

- Extend the timeframe of the first review of the Rate of Return Guideline from three years to five years. This requires the AER to review the Rate of Return Guideline by no later than 17 December 2018.
- Provide under the NER, a specific transitional arrangement to provide additional regulatory certainty for TasNetworks, Power and Water Corporation, Ausgrid, Endeavour Energy, Essential Energy, and ActewAGL.

The purpose of these changes is to allow for better information to be incorporated into the first review of the Rate of Return Guideline, and to minimize uncertainty in its implementation. The Commission's reasons for making this final rule determination and the final rules are set out in section 2.4 and Chapters 3 to 5.

2.2 Rule making test

Under s. 88(1) of the NEL and s. 291(1) of the NGL, 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 and the NGO. This is the decision making framework that the Commission must apply.

The NEO is set out in s. 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.”

The NGO is set out in s. 23 of the National Gas Law, as follows:

“The objective of this Law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.”

2.2.1 Northern Territory legislative considerations

From 1 July 2016, the Commission assumed rule making responsibility for parts of the NER adopted by the Northern Territory.¹⁵ The Commission already had rule making responsibility for the NT under the NGR. As the proposed rule relates to parts of the NER that apply in the Northern Territory, the Commission is required to assess the proposed rule against additional elements required by Northern Territory legislation.¹⁶

The *National Electricity (Northern Territory) (National Uniform Legislation) Act 2015* allows for an expanded definition of the national electricity system in the context of the application of the NEO to rules made in respect of the Northern Territory. The Commission must regard the reference in the national electricity objective to the “national electricity system” as a reference to whichever of the following the Commission considers appropriate in the circumstances having regard to the nature, scope or operation of the proposed rule:

- (a) the national electricity system;
- (b) one or more, or all, of the local electricity systems;
- (c) all the electricity systems referred to above.

For this rule change, the Commission will regard the reference to the “national electricity system” as a reference to the “national electricity system” and all of the local electricity systems.

The *National Electricity (Northern Territory) (National Uniform Legislation) Act 2015* also provides the Commission with the ability to make a differential rule that varies in its terms between the national electricity system and the Northern Territory’s local electricity system. A differential rule is a rule that:

- (a) varies in its term as between –
 - (i) the national electricity system; and
 - (ii) one or more, or all, of the local electricity systems; or
- (b) does not have effect with respect to one or more of those systems,

but is not a jurisdictional derogation, participant derogation or rule that has effect with respect to an adoptive jurisdiction for the purpose of s. 91(8) of the NEL.

¹⁵ See [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)) for details about parts of the NER adopted by the Northern Territory.

¹⁶ *National Electricity (Northern Territory) (National Uniform Legislation) Act 2015*.

The Commission has considered whether a differential rule is required for the Northern Territory electricity service providers and concluded that it is not required in this instance. This is because the regulatory determination process and the regulator are now the same for service providers in the Northern Territory as for service providers in other jurisdictions, and the specific issues of Power and Water Corporation are addressed through the transitional provisions.

2.2.2 Western Australian gas pipelines

Western Australian gas pipeline service providers are currently regulated by the ERA. However, the Government of Western Australia is currently progressing its 'Transfer of Regulatory Functions Project' that is designed 'to transfer the functions for regulating Western Australian gas pipelines from the [ERA] to the [AER]'.¹⁷ On 22 June 2016, the Government of Western Australia introduced a package of legislation into its Parliament to implement the reforms to regulated electricity networks and gas pipelines. As part of this process, the regulatory functions for regulating Western Australian gas pipelines is proposed to be transferred to the AER in 2018.

Of the three gas pipelines subject to full regulation in Western Australia, ATCO Gas Australia could possibly be affected by this rule as its access arrangement process is currently scheduled to occur during 2018.¹⁸ However, this transfer, and the timetable for the transfer and transitional arrangements are not finalised. If required and appropriate, both the ERA and AER have some capacity to change the dates related to ATCO lodging its proposed revised access arrangement.

If the transfer proceeds, the AER's Rate of Return Guideline is expected to apply to Western Australian service providers in their future revenue and access determinations. If the transfer of regulatory function does not occur by the proposed date, the ERA will be required to undertake a review of its Rate of Return Guideline by 18 December 2018 to be consistent with this final rule.

2.3 Assessment framework

In considering this rule change request, the Commission assessed it against the NEO and NGO. In particular, it considered whether the proposed rules would be likely to promote efficient investment in electricity and gas services for the long term interests of consumers. This aspect of both the NEO and NGO is the most relevant as the rule change request sought to allow the most current information available related to the calculation of the rate of return to be included in the Guideline.

¹⁷ Information on the Transfer of Regulatory Functions Project for Western Australia can be found at https://www.finance.wa.gov.au/cms/Public_Uilities_Office/Electricity_Market_Review/Transfer_of_Regulatory_Functions.aspx

¹⁸ Information on the current access arrangement process for Western Australian gas pipeline operators can be found at www.erawa.com.au.

In assessing the rule change request against the NEO and NGO, the Commission considered the following principles:

- **Transparency of information:** clear, accountable and relevant information is provided to stakeholders in order to support the efficient investment in electricity and gas services;
- **Benefits and costs:** the benefits of extending the Guideline review deadline should be greater than the counterfactual, and the costs of extending the Guideline review deadline should be less than the counterfactual.

The Commission also assessed the rule change request against the relevant counterfactual arrangements, which would require the AER to complete a review of the Guideline by 17 December 2016.

2.4 Summary of reasons

The final rules made by the Commission (including the NER transitional provisions) have been published with this final rule determination.

The final rules amend the arrangements in Chapter 6 and 6A of the NER; and rule 87 of the NGR with respect to the first interval of the review of the Rate of Return Guidelines. These rules will commence on 20 October 2016.

The key features of the final rules are that:

- the period for the first review of the Rate of Return Guideline has been extended from three to five years;
- the new review deadline, based on the publication date of the first Guideline, is 17 December 2018;
- subsequent review periods of the Rate of Return Guideline remain at three year intervals; and
- the current (2013) version of the Rate of Return guideline will remain effective for all regulatory determination and access arrangement processes until such time as a new Guideline is published.

The key features of transitional arrangements in the NER are that:

- the current (2013) version of the Guideline will apply to the 2018-2019 regulatory determination processes for the six affected service providers;
- the provisions apply only in respect of the first review of the Guideline; and
- the provisions do not prevent affected service providers, or the AER, from being able to depart from the 2013 Guideline as they are currently able.

The reasons for making these final rules, with transitional provisions in the NER, are set out in Chapters 3 to 6. In summary, the Commission is satisfied that the final rules will, or are likely to contribute to the achievement of the NEO and NGO because:

- The AER will be more likely to be able to provide more relevant and current information in the first review of the Guideline as the final rules would allow the AER time to fully consider the outcomes from the FCA proceedings and related processes.

- A revised Guideline with more up to date information will show how the AER intends to approach the rate of return objective. This may increase the likelihood of efficient outcomes in the regulatory determination and access arrangement processes.
- Up-to-date information in the Guideline has the potential to reduce regulatory costs, and lower the risk of (and costs associated with) reviews of future regulatory determinations and decisions.
- The transitional provisions in the NER will provide additional regulatory certainty to affected service providers regarding the implementation of the proposed rule.

2.5 Strategic priority

The rule change request relates to the Commission's strategic priority on providing market and network arrangements that encourage efficient and appropriate investment over time. This strategic priority recognizes that better information communicated between regulators and service providers with regard to the regulatory determination process will indirectly benefit small customers as this has potential to reduce costs for service providers.

The final rules are expected to allow better information to be incorporated in the first review of the Rate of Return Guideline. This is likely to improve the regulatory determination process for affected service providers.

3 Issues

The Commission has analysed the rule change request and assessed the issues arising from it. For the reasons set out below, the Commission has determined that final rules be made and that transitional provisions be made in the NER.

3.1 Extending the Guideline review deadline

The Commission considers that there is little benefit in conducting a review of the Guideline while core components of it are still in contention before the FCA. The Commission considers that extending the timeframe for the first Guideline review by two years will be likely to allow the AER and stakeholders sufficient time to consider the outcomes of the proceedings and for the AER to consult, develop and publish a revised Guideline.¹⁹ Additionally, attempting to review the Guideline under such uncertainty by the current December 2016 deadline would likely add regulatory costs for stakeholders, and result in a Guideline that may not contain relevant or current information.

The Commission considers that if the proposed rules were made, the impact on the energy market would not be materially different from current arrangements as the existing (2013) Guideline would still be in force until the new guideline is published. Therefore, the proposed rules would not impose any additional costs on service providers. Additionally, the flexibility for both service providers and the AER to depart from the guideline is retained.

On this basis, the Commission has determined to make final rules that extend the timeframe of the first review of the Rate of Return Guideline from three years to five years. It considers the rules will, or are likely to, contribute to the achievement of the national electricity and national gas objectives. This is because it considers the rules will promote efficient investment in electricity and gas services for the long term interests of consumers.

The rules will allow time for the outcomes of the FCA proceedings and related processes to be taken into account in the review process. Including relevant, up-to-date information in the Guideline has the potential to reduce regulatory costs, and lower the risk of (and costs associated with) reviews of future regulatory determinations and decisions. The final rules require the AER to review the Rate of Return Guideline by no later than 17 December 2018. These issues are discussed in more detail in Chapter 4.

3.2 Review deadline timing and the need for regulatory certainty

The Commission has established that the proposed review deadline presents a significant issue for the six affected service providers as it will limit their ability to consider any revisions to the Guideline and decide on whether and how to either incorporate or depart from the Guideline in their regulatory proposals. All the affected

¹⁹ A risk does remain that the AER may not have sufficient time to complete a review of the Guideline by 17 December 2018 because there is no set timeframe for the FCA decisions and related processes to finalise.

service providers are electricity network service providers. On this basis, the Commission considers that transitional provisions are necessary in the NER to provide additional regulatory certainty to this process.

After considering a number of options, the Commission has determined that its transitional provisions, as set out in the consultation paper, are likely to add regulatory certainty to affected service providers. The provisions also retain the flexibility mechanisms for affected service providers and the AER, which preserves the ability for the rate of return objective to be met. The transitional provisions establish that the current (2013) version of the Guideline will apply to the 2018-2019 regulatory determination processes for the six affected service providers.

An evaluation of the different transitional provision options is provided in Chapter 5.

4 Extending the Guideline review deadline

4.1 AER's view

In its rule change request, the AER identified that the primary reason for extending the Guideline review deadline is that key elements²⁰ of the current Guideline are in dispute and are being considered by the ACT and FCA. It stated:²¹

“The outcome of these legal processes is unlikely to be known before 17 December 2016 and may not be known within the next 12 months. The outcome of these legal processes may cause a change in the AER's approach to setting the allowed rate of return and hence trigger a review of the Guideline. It would not be prudent to conduct a Guideline review by December 2016, when fundamental issues about the appropriate application of the legislative framework are likely to be unresolved by that time, and if an amended Guideline would be superceded shortly after... The AER considers there is no value in commencing a Guideline review before the Tribunal and FCA processes are settled.”

The AER considered that the proposed rules would provide certainty as it would allow more time for the legal processes to finalise, and that this in turn will allow more time for the AER to consult on, and incorporate better and more relevant information into the revised Guideline.

The AER also claimed that the proposed rules would 'reduce the cost and regulatory burden associated with conducting a Guideline review by 17 December 2016'.²²

In its proposal, the AER noted that service providers would maintain 'the current available flexibility to depart from the Guideline in a regulatory proposal or determination (if doing so would contribute to the achievement of the allowed rate of return objective)'.²³ It also noted that the proposed rules 'will result in regulatory proposals submitted between 17 December 2016 and 17 December 2018 being required to identify departures from the current Guideline, rather than a reviewed (and potentially amended) Guideline'.²⁴ Further, it did not consider that the identification of these departures will have a material impact.

²⁰ Key elements relate to the return on debt, and the value of imputation credits (which the rate of return must be consistent with).

²¹ AER, Request for a rule change, 7 June 2016, p. 2.

²² AER, Request for a rule change, 7 June 2016, p. 3.

²³ AER, Request for a rule change, 7 June 2016, p. 4.

²⁴ AER, Request for a rule change, 7 June 2016, p. 3.

4.2 Stakeholder views

Delay of the Guideline

Stakeholders all expressed in-principle support for the review deadline to be extended. For example the Electricity Networks Association (ENA) stated that it:²⁵

“...supports the AER’s rule change proposal to alter the relevant provisions of the National Electricity Rules and National Gas Rules and its rationale for the change....the deferral of the Rate of Review Guideline review will provide greater certainty to stakeholders during the review process.”

ActewAGL stated that it 'supports the motivation for the Rule change request from the AER to extend the deadline to review the Current Guidelines'.²⁶

Stakeholders mostly commented that delaying the review deadline would be beneficial in that it would allow the AER time to incorporate new information from the FCA decisions and related processes into a revised Guideline. AusNet Services stated that:²⁷

“...given that significant areas of the current Guideline are currently under review by the Australian Competition Tribunal and the Federal Court, it is sensible to extend the December 2016 deadline for the second Rate of Return Guideline to enable it to reflect the outcomes of those reviews.”

Energex noted that 'these appeal processes could significantly influence the estimation of the allowed rate of return in future regulatory determinations'.²⁸ Darach Energy Consulting Services also noted that 'the AER can take into account any changes to the regulatory framework arising from the [Limited Merits Review] review and any relevant Rule changes determined by the AEMC'.²⁹

Essential Energy considered that the proposed rules would reduce the regulatory burden on service providers. It stated that 'the guideline review is extremely time and resource intensive for all stakeholders, so a deferral will eliminate duplicated effort and costs that may result from attempting to predict outcomes of the merits and judicial processes'.³⁰

Similarly, SA Power Networks also noted that:³¹

“...if a revised Guideline came into effect late in 2018, there would be inadequate time for SA Power Networks and other network service providers to properly prepare their regulatory proposals. It would be unreasonable and costly for an NSP to commence preparation of its

25 ENA, consultation paper submission, p. 1.

26 ActewAGL, consultation paper submission, p. 1.

27 AusNet Services, consultation paper submission, p. 1.

28 Energex, consultation paper submission, p. 1.

29 Darach Energy Consulting Services, consultation paper submission, p. 2.

30 Essential Energy, consultation paper submission, p. 1.

31 SAPN, consultation paper submission, p. 1.

proposal on the basis of one version of the Guideline and then have to amend or repeat the analysis to comply with a new version.”

Ergon Energy noted, more broadly, that 'regulatory certainty should exist for all NSPs as to what Guideline applies at any/all stages of their determination processes and from what Guideline departures will be possible. Significant time and effort is required to formulate and incorporate a position in this regard'.³²

Flexibility mechanisms

Three stakeholders provided commentary about the benefits and the potential costs associated with the ability for service providers to depart from the Guideline. The ENA noted:³³

“...that since the Rate of Return Guideline is non-binding, sufficient flexibility exists to accommodate changes in market conditions at any point in time, i.e. during individual regulatory and access arrangement determinations. In view of the above, the ENA considers that the rule change will promote the National Electricity and Gas Objectives for the long-term interests of consumers in promoting clear efficient investment signals and minimising regulatory costs, where circumstances justify it.”

Furthermore, Essential Energy noted that 'given the non-binding nature of the guideline, there would be sufficient flexibility... to accommodate departures from the 2013 guideline, where appropriate, in light of market developments or outcomes of the merits and judicial reviews'.³⁴

In contrast, ActewAGL noted that it 'will likely be required to identify departures from the Current Guidelines in its estimation of the return on debt, return on equity and allowed rate of return in its regulatory proposal notwithstanding that those Guidelines have been found to be affected by reviewable error and will necessarily be departed from by the AER in decision-making, ' and that as a result, it 'will otherwise incur additional regulatory costs without any associated benefit'.³⁵ As a result of the perceived costs to depart, ActewAGL proposed that the Commission consider 'accompanying transitional provisions' to 'exclude the operation of the requirement under the Rules for [ActewAGL] to identify departures from the Rate of Return Guidelines in respect of its regulatory proposal for the next [Regulatory Control Period]'.³⁶

4.3 Analysis and conclusions

Delay of the Guideline

The Commission considers that delaying the first review of the Guideline to allow the AER to incorporate more up to date information would be consistent with a transparent

³² Ergon Energy, consultation paper submission, p. 2.

³³ ENA, consultation paper submission, p. 1.

³⁴ Essential Energy, consultation paper submission, p. 1.

³⁵ ActewAGL, consultation paper submission, p. 5.

³⁶ ActewAGL, consultation paper submission, p. 5.

regulatory process. The matters under review by the FCA are relevant to how the AER will propose to estimate the allowed rate of return in future regulatory decisions, including how its methodologies will result in determinations that are consistent with the allowed rate of return objective. Delaying the review of the Guideline is likely to allow more time for the both the AER and service providers to consider the relevant outcomes from the FCA decisions and related processes. The Commission also notes uniform support for the review of the Guideline deadline to be extended on this basis.

The Commission considers that if the proposed rules were made, the impact on the energy market would not be materially different from current arrangements. Under the proposed rules, the existing (2013) Guideline would still be in force until the new guideline is published. Additionally, under current arrangements, if the AER were to carry out a review of the Guideline by 17 December 2016, there would likely be regulatory costs for service providers to participate in the required consultation process. The effect of the proposed rules would be to delay these regulatory costs until such time as the AER commences the review in, or before, 2018 without a detrimental impact on the use of the 2013 Guideline.

On balance, the Commission considers that the proposed rules are an appropriate response that balances the risks of keeping the Guideline up to date with the unresolved FCA decisions and related processes. The two year extension of time for the first review of the Guideline is likely to be enough time for these legal processes to complete and for the AER to complete a review of the Guideline. As there is no set timeframe for the completion of these legal processes, however, a risk does remain that the AER may not have sufficient time to complete a review of the Guideline by the proposed date.

Flexibility mechanisms

The ability for service providers to depart from a Guideline provides the flexibility for them to better align their regulatory proposals with the rate of return objective in circumstances where a Guideline methodology may not be appropriate.³⁷ In addition, the requirement to identify and explain departures is an accountability mechanism built into the framework

ActewAGL suggested that this mechanism be removed for the affected service providers in respect of the 2018 regulatory process. To do so, however, may introduce risks that service providers may make (unintended or otherwise) departures that are not in the long term interests of consumers. In such circumstances, not requiring an explanation of a departure from the Guideline can result reduced accountability. Moreover, if service providers only propose to make departures to ensure consistency with outcomes arising from the FCA decisions and related processes, then identifying departures is not likely to be a significant regulatory burden.

On this basis, the Commission does not consider it appropriate to remove the requirement for affected service providers to identify departures from the 2013 Guideline.

³⁷ The ability for service providers to depart from the Guideline is set out in Schedules 6.1.3(9) and 6A.1.3 of NER and rule 72(1)(g) of NGR.

5 Review deadline timing and the need for regulatory certainty

5.1 AER's view

In its rule change request, the AER noted that some service providers may be particularly affected by the proposed rules. It stated that 'some businesses may be affected by the outcome of the Guideline review under the proposed timeframe extension'.³⁸

However, it viewed that adjusting these timeframes would not have a material impact. The rule change request stated:³⁹

“In the AER's view, these timing changes, at an overall level, do not have a material impact. Conducting a Guideline review at any point in time is likely to impact on one or more of the AER's regulatory determination processes...We do not consider that the proposed rule change, at an overall level, exacerbates these impacts relative to the current Rules.”

The AER subsequently stated that, to address any issues, it would 'develop a structure and schedule for all stakeholders to comment on developments in the review of the Guidelines and how they may impact the regulatory determination/access arrangement processes that may be running concurrently'.⁴⁰ It also stated that stakeholders would be provided with reasonable opportunity to comment on developments in the Guideline review and how regulatory determination processes may be affected.

5.2 The Commission's proposed transitional provisions

In its consultation paper, the Commission stated that in its view, there was potential for the proposed review deadline to cause implementation issues for specific service providers who would be in the midst of their regulatory determination process when the new Guideline would be published.

As outlined in section 1.5, the Commission noted that the proposed Guideline review deadline (17 December 2018) may be particularly problematic for six affected service providers (TasNetworks, Power and Water, Ausgrid, Endeavour Energy, Essential Energy, and ActewAGL). The concern was that scenarios may arise where the revised Guideline is published before an affected service provider has submitted its revised regulatory proposal. This was considered as potentially problematic as affected service providers may be unlikely to have had sufficient time to consider it and decide on whether and how to either incorporate or depart from the Guideline in their revised regulatory proposals.⁴¹

³⁸ AER, Request for a rule change, 7 June 2016, p. 1.

³⁹ AER, Request for a rule change, 7 June 2016, p. 4.

⁴⁰ AER, Request for a rule change, 7 June 2016, p. 4

⁴¹ The revised regulatory proposal is the last point at which a service provider can respond to the AER's draft determination on the service provider's revenue proposal.

To address this implementation issue, the Commission indicated that final rules could include transitional provisions that would specify the arrangements from the outset. It considered that transitional provisions could provide regulatory certainty to the affected service providers and other stakeholders who may participate in those regulatory processes.

The Commission's initial view was that if transitional provisions were necessary, the most appropriate approach would be for the provisions to specify that the current 2013 Guideline would apply to the 2018 regulatory determination processes for the six affected service providers. This is in contrast to affected service providers having to consider, in the one regulatory process, a 2013 Guideline, any potential departures from that Guideline, and then to consider an additional revised Guideline. Additionally, such provisions would only apply in respect of the first review of the Guideline and would not prevent affected service providers, or the AER, from being able to depart from the 2013 Guideline as the NER and NGR currently provide.⁴²

The Commission sought feedback from stakeholders on the extent to which this timing issue was significant, and why. Feedback was also sought as to whether the proposed transitional provisions set out in the consultation paper would be likely to address the issue.

5.3 Stakeholder views

Significance of the issue the need for transitional provisions

Most stakeholders commented that the timing issue created by the proposed review deadline was a significant issue, and supported the use of transitional provisions to address the issue. Ausgrid noted that 'this is an important issue for affected service providers'.⁴³ ActewAGL stated that the 'proposed solution of extending the review deadline for the Guidelines by two years, from 17 December 2016 to 17 December 2018, poses difficulties for [ActewAGL]'s ACT electricity distribution reset process for the next [regulatory control period]', and that 'under the AER's proposed Rule change, either [ActewAGL] will have to address the Current Guidelines in its revised regulatory proposal (if the Revised Guidelines are not published prior to the submission of that proposal) or [ActewAGL] will have to address the Revised Guidelines in its revised regulatory proposal but without sufficient time to properly do so (if the Revised Guidelines are published prior to the submission of that proposal)'.⁴⁴ Essential Energy also expressed 'support [for] the AEMC's position to use transitional provisions'.⁴⁵

Queensland and South Australian service providers, who are due to submit their first regulatory proposals in early 2019 for their next scheduled revenue determination process, expressed concern that the December 2018 review deadline would be problematic. Energex noted that 'the review deadline of 17 December 2018 is also

⁴² Those parties that wish to depart from the relevant Guideline would still be able to do so, subject to providing reasons for such departure.

⁴³ Ausgrid, consultation paper submission, p. 1.

⁴⁴ ActewAGL, consultation paper submission, p. 2,3.

⁴⁵ Consultation paper submissions: Essential Energy, p. 1; Energex, p. 1.

potentially problematic for Queensland distributors, given that Energex is expected to submit its initial regulatory proposal by 31 January 2019'.⁴⁶ It also commented that it 'supports in principle the AEMC's proposal to include transitional provisions as this provides regulatory certainty for stakeholders'.⁴⁷ Ergon Energy also noted that, with respect to a December 2018 review deadline, it has 'concerns as to whether there will be sufficient time to consider, and decide on whether and how to either incorporate or depart from the Guideline in this regard'.⁴⁸ SA Power Networks also noted that 'if a revised Guideline came into effect late in 2018, there would be inadequate time for SA Power Networks and other network service providers to properly prepare their regulatory proposals'.⁴⁹

No service providers indicated that the timing issue created by the proposed review deadline of December 2018 was not significant.

In its submission to the Commission's consultation paper, the AER did not consider that transitional provisions would be required. Its view was that 'the current regulatory framework is sufficiently flexible to address any issues created by a revised timing of the Rate of Return Guideline review'.⁵⁰ It also stated, that 'transitional provisions may introduce complexity and rigidity into the framework'.⁵¹

The Commission's proposed transitional provisions

There was a range of views with respect to the Commission's proposed transitional provisions as outlined in the consultation paper.

Some stakeholders considered that the Commission's proposed transitional provisions may not be effective or provide the outcomes that it intended. For example, ActewAGL considered that affected service providers would base their proposals on the 2013 Guideline which 'does not deliver the meaningful signal of the AER's methodologies' and that 'the Current Guidelines are incapable of doing so'.⁵² It further noted that service providers would need to depart from the 2013 Guideline, and that this would involve additional regulatory costs to service providers and the AER.⁵³

In addition, the AER did not consider that the Commission's transitional provisions would be effective. In its view, the Commission's 'transitional arrangements may not have sufficient flexibility to cope with the range of potential outcomes and could impinge upon the primacy of the allowed rate of return objective'.⁵⁴ The AER also considered that 'the benefits of the proposed transitional provisions may be outweighed by the potential uncertainty and complexity involved in their application', and that this

46 Energex, consultation paper submission, p. 1.

47 Energex, consultation paper submission, p. 2.

48 Ergon Energy, consultation paper submission, p. 2.

49 SAPN, consultation paper submission, p. 1.

50 AER, consultation paper submission, p. 1.

51 *ibid.*

52 ActewAGL, consultation paper submission, p. 5.

53 This specific issue was discussed in Chapter 5.

54 AER, consultation paper submission, p. 1.

may 'negatively impact the process of consultation on our draft decision and service providers' revised proposals'.⁵⁵ Additionally, the AER noted that there is a possibility that it could publish its 'review of the Rate of Return Guideline before [its] draft decisions for these affected service providers', and that the proposed transitional provisions could then act as an obstacle in meeting the rate of return objective.⁵⁶

Other stakeholders, however, supported the Commission's proposed transitional provisions. They indicated that such provisions would add regulatory certainty while retaining flexibility for affected service providers. Essential Energy considered that 'transitional provisions suggested by the AEMC in the consultation paper, namely that the current 2013 guideline will apply to Essential Energy's next determination, are necessary in order to remove any ambiguity'.⁵⁷ Endeavour Energy also noted that it supported:⁵⁸

“...the AEMC's position to use transitional provisions to specify that the current 2013 Guideline would apply to the 2019-24 regulatory determination processes of the affected service providers (of which Endeavour Energy is one), rather than the revised Guideline published following the review process. We also agree with the transition provisions only applying in respect of the first review of the Guideline and not preventing affected service providers, or the AER, from being able to depart from the 2013 Guideline.”

Ausgrid stated that it 'would support any outcome from the AEMC that delivers greater regulatory certainty to affected service providers'.⁵⁹ It also expressed concern that measures other than the AEMC's initial proposal may 'result in a different outcome'.⁶⁰

Alternative review deadline dates

A number of stakeholders indicated that the proposed December 2018 review deadline was not satisfactory for their regulatory processes. These stakeholders suggested alternative deadline dates, either in addition to, or in place of, the Commission's proposed transitional provisions. These included recommendations that the review deadline be brought forward, or postponed further.

ActewAGL, for instance, requested that the review deadline be brought forward to June 2018. In its view, this 'should provide sufficient time for the AER to issue the Revised Guidelines and reflect them in its draft determination for [ActewAGL]'s ACT electricity distribution reset process for its 2019/20 to 2023/24 regulatory control period...and would ensure a meaningful opportunity for [ActewAGL] to consider and respond to the Revised Guidelines in preparing its revised regulatory proposal'.⁶¹

55 AER, consultation paper submission, p. 2.

56 AER, consultation paper submission, p. 2.

57 Essential Energy, consultation paper submission, p. 1.

58 Endeavour Energy, consultation paper submission, p. 1.

59 Ausgrid, consultation paper submission, p. 1.

60 Ausgrid, consultation paper submission, p. 1.

61 ActewAGL, consultation paper submission, p. 1.

Both Australian Gas Networks and SA Power Networks suggested that the review deadline be brought forward to at least October 2018. SA Power Networks preferred this date as 'December 2018 would be problematic for SA Power Networks and other network service providers who must lodge their 2020-25 regulatory proposals by 31 January 2019'.⁶² Australian Gas Networks noted that October 2018 would allow 'stakeholders to consider the impact of the current merits and judicial review proceedings on the revised Guideline' and 'those businesses submitting their regulatory proposals in January and February 2019, to consider and incorporate the revised Guideline into their submissions'.⁶³

Alternatively, Endeavour Energy supported further postponing the Guideline to May or June 2019. It argued that 'this outcome ensures the disputed elements currently before the merits and judicial reviews are incorporated into the new Rate of Return review, without limiting Endeavour Energy's ability to engage in the Rate of Return consultation phase'.⁶⁴

The three-month mechanism

Four service providers considered the merits of establishing a three-month mechanism. Such a mechanism would establish that the Guideline that has been published at least three months prior to a service provider's first regulatory proposal submission is the Guideline that applies to that regulatory process.⁶⁵ In addition, one submission indicated support for such a mechanism, but that the timeframe should be four months as a minimum.⁶⁶ Some stakeholders recommended that this mechanism be either in place of, or in addition to, other measures.

Energex noted that such arrangements would 'not only provide network businesses with certainty regarding the applicable Guideline but also sufficient time to consider the Guideline'.⁶⁷ Ergon Energy stated that it 'considers transitional provisions should denote that the version of the Guideline in place a defined number of months (preferably at least 3 months) before the submission of an initial regulatory proposal, applies therein'.⁶⁸

AusNet Services noted that such a mechanism should allow for a four month period between the publication of a Guideline and the submissions of a revenue proposal. In its view, it considers that 'four months is the minimum time required to properly consider, and consult with its stakeholders, on how a revised Guideline will be applied in its Revenue Proposal'.⁶⁹

⁶² SAPN, consultation paper submission, p. 1.

⁶³ AGN, consultation paper submission, p. 1; SAPN, consultation paper submission, p. 1.

⁶⁴ Endeavour Energy, consultation paper submission, p. 1.

⁶⁵ Consultation paper submissions: Energex, p. 2; SAPN, p. 2; Essential Energy, p. 2; Ergon Energy, p. 2.

⁶⁶ AusNet Services, consultation paper submission, p. 1.

⁶⁷ Energex, consultation paper submission, p. 2.

⁶⁸ Ergon Energy, consultation paper submission, p. 2.

⁶⁹ AusNet Services, consultation paper submission, p. 1.

There was some variation in terms of how the three-month mechanism could be applied. SA Power Networks considered that this model should be applied to the current affected service providers.⁷⁰ Energex considered that this model be extended to capture those service providers commencing their regulatory proposals in early 2019.⁷¹ Essential Energy and Ergon Energy argued that this mechanism should be applied more broadly to all regulatory determination and access arrangement processes.⁷²

5.4 Analysis and conclusion

The Commission considered the range of approaches presented to address the review deadline issue. Many stakeholders suggested single approach measures to address the timing issue, while a small number of stakeholders recommended combinations of 'stacked' alternative measures that could operate in tandem. More broadly, the Commission considers that when the outcomes are the same, simpler solutions are preferred to complex solutions. For this reason, the discussion below is in reference to the single approach measures only.

Significance of the issue and the need for transitional provisions

The Commission considers that the extension of the review deadline to December 2018 creates uncertainty and places constraints on the ability for six service providers to appropriately consider information from a new guideline. Additionally, the Commission considers that there is limited flexibility, in this instance, for the AER to develop, consult and publish a revised Guideline, and also allow a sufficient amount of time for service providers to adequately consider it, given the uncertainty of when the FCA decisions and related processes will finalise. On this basis there is sufficient cause to warrant the creation of transitional provisions to provide additional clarity, in advance, regarding the 2018 regulatory process for affected service providers.

The Commission also notes the submissions from service providers due to submit their regulatory proposals in early 2019. These service providers, however, will have had approximately two months to consider the content in the Guideline and will have time within the process to consider the application of a revised Guideline. They will also have had the opportunity to engage with the AER in its Guideline review consultation process well in advance of their submission dates including reviewing the AER's draft Guideline. The issues identified for the affected service providers, however, are more acute due to their determination processes being more than halfway complete which limits their opportunity to respond to the 2018 Guideline.

The Commission's proposed transitional provisions

The Commission acknowledges the mixed response to its proposed transitional provisions. The Commission has considered the alternatives and is satisfied that its proposed transitional provisions meet the needs of the relevant service providers in a clear and efficient manner, and promotes the transparency of information to enhance regulatory certainty, while retaining sufficient flexibility for affected service providers.

⁷⁰ SAPN, consultation paper submission, p. 2.

⁷¹ Energex consultation paper submission, p. 2.

⁷² Consultation paper submissions: Essential Energy, p. 2; Ergon Energy, p. 2.

Additionally, the Commission considers that this approach retains the ability of the regulatory process to deliver outcomes that are consistent with the rate of return objective.

Noting submissions from ActewAGL, the Commission does not consider that the proposed transitional provisions would increase the need for affected service providers to depart from the 2013 Guideline. Under the Commission's proposed approach, the current 2013 Guideline will apply to the 2018 regulatory determination process for the affected service providers. In contrast, the AER's proposal could result in affected service providers commencing their regulatory process using the 2013 Guidelines, but then having to consider an additional revised 2018 Guideline towards the end of that process. In both scenarios, affected service providers commence their process with the 2013 Guideline, and in both scenarios, service providers can depart from the Guideline, with appropriate justification. The transitional provisions, however, remove the need for affected service providers to then consider an additional revised 2018 Guideline late in their regulatory process.

The AER commented that proposed transitional arrangements may restrict its ability to make determinations that are consistent with the rate of return objective. Specifically, it claimed that if the review of the Guideline is completed sufficiently in advance of the relevant draft decisions, then the transitional provisions may limit the AER's ability to use the information in the revised Guideline. The Commission notes, however, that the ability to depart from the Guideline is also preserved for the AER. Should the AER find it appropriate to depart from the 2013 Guideline, then it is still free to do so, with appropriate justification. On this basis, the ability for the AER to make decisions consistent with the rate of return objective is preserved.

While the AER may find itself in a position to publish a revised Guideline early, there are many factors that would have to align for this to be possible. For instance, delays to FCA decisions and related processes, delays in the development and consultation on a new revised Guideline, while ensuring that a sufficient period time is allotted for service providers to appropriately consider the revised Guideline, all increase the risk that the AER may not meet a timeframe earlier than December 2018.

Alternative review deadlines

A number of stakeholders suggested that the review deadline should be earlier than December 2018. The Commission acknowledges that bringing the date forward could potentially provide the affected service providers with sufficient time to appropriately consider a revised Guideline. The Commission also notes that there may be benefits for those service providers due to submit their first regulatory submissions in late January 2019, as they would similarly have additional time to appropriately consider a revised Guideline.

However, bringing the review deadline forward increases the very real risk that the AER will not be able to meet this deadline. As discussed above, there is uncertainty regarding when the FCA decisions and related processes will finalise. In addition, the AER will need a sufficient amount of time to consider the findings, and then to develop, prepare, consult and publish a new Guideline. The Commission notes that the first Rate

of Return Guideline took approximately 12 months to complete and included a broad ranging consultation as required under the NER and NGR.⁷³ Under the current proposal to extend the revision date to December 2018, there still remains a risk that if the FCA decisions and related processes take longer than currently expected, and/or the AER's guideline consultation process takes longer than anticipated, the AER may still not meet this deadline.

With respect to those service providers due to submit their first regulatory submissions by the end of January 2019, as has previously been noted, they will have had approximately two months to consider the revised Guideline. They will also have time within the process to consider its application, and will have had the early opportunity to engage with the Guideline review consultation process.

On these grounds, the Commission has concluded that bringing the review deadline forward from December 2018 is not preferable to the proposed rules or to the Commission's approach to the transitional provisions.

Similarly, the Commission considers that further delaying the guideline is not preferable to the Commission's approach to the transitional provisions. There may be some benefit in allowing additional time for the FCA decisions and related processes to finalise, however, delaying the review deadline does not remove the timing issues relevant to the affected service providers. Delaying the review only moves these issues onto a different set of service providers, noting that five service providers are due to submit their first regulatory proposals for their next scheduled review process by the end of January 2019. As mentioned above, under the AER's proposed deadline, these service providers will still have capacity to consider a revised 2018 guideline prior to, and within, their review process. Should the review deadline be further delayed, the capacity for these service providers to consider the revised guideline is reduced.

The three-month mechanism

The three-month mechanism has been proposed to establish that the Guideline that has been published at least three months prior to a service providers' first regulatory proposal submission is the Guideline that applies to that regulatory process. The Commission notes that there are three variations of this model. The first relates to the application of this model to the affected service providers. The second variation of the model would also apply to the affected service providers due to submit their first regulatory proposal in early 2019. The third variation of this model proposes a permanent amendment to the rules that would apply to all regulatory determination processes going forward.

The first variation of this model would apply to the affected service providers. The Commission notes that in practice, the effect of this model would not substantially differ from the Commission's proposed transitional provisions. For example, this version of model would require that the Guideline that is in place by the end of October 2017 (three months prior to the end of January 2018, which is the first submission for the

⁷³ Consultation procedures for the Rate of Return Guideline are set out in s.(s) 6.16 and 6A.20 of the NER, and rule 9B of the NGR

2018 regulatory process) would be the Guideline that applies to the 2018 regulatory process. In this scenario, the 2013 Guideline would apply to the 2018 regulatory process given that it is very unlikely that the revised Guideline would be ready by the end of October 2017. In effect, this would result in the same outcome as the Commission's proposed transitional arrangements as affected service providers would not have to consider a new 2018 Guideline, but would still have to consider the 2013 Guideline.

However, while it would be unlikely that the revised Guideline would be ready by the end of October 2017, and that the outcome would be the same as the Commission's proposed transitional arrangements, this information may not be known until mid to late 2017. In this respect, this variation of the three-month model introduces uncertainty into the process that the Commission's proposed transitional arrangements avoid.

The second variation is similar to the first, except that it would also apply to the regulatory process commencing in 2019, and would require that the Guideline that is in place by the end of October 2018 to be the Guideline that applies. Should the revised Guideline, however, be published in December 2018, then the 2013 Guideline will apply to the 2019 process. Similarly, the additional uncertainty presented from the first variation remains. In addition, as has been discussed above, these service providers will still have opportunity to engage with the AER in its Guideline review consultation process well in advance of the revised deadline. On this basis, the Commission does not consider this variation of the model preferable to the Commission's approach to the transitional provisions.

However, the more general application of the three month mechanism may provide the benefit of addressing the ongoing timing issues that arise from the coincidence of the guideline review process and the AER's regulatory decisions. The application of this general rule, however, is not within the scope of the issues raised in the rule change request which were related to extending the initial Guideline review process in light of the outstanding FCA decisions and related processes. However, this conclusion in this context does not preclude the AEMC's consideration of a future rule change request of this nature.

Abbreviations

ACT	Australian Competition Tribunal
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
affected service provider	TasNetworks, Power and Water Corporation, Ausgrid, Endeavour Energy, Essential Energy, and ActewAGL
Commission	See AEMC
Guideline	Rate of Return Guidelines
ENA	Electricity Networks Association
ERA	Economic Regulation Authority of Western Australia
FCA	Federal Court of Australia
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEO	national electricity objective
NER	National Electricity Rules
NGL	National Gas Law
NGO	national gas objective
NGR	National Gas Rules
service providers	electricity network and gas pipeline service providers

A Summary of issues raised in submissions

Stakeholder	Issue	Commission response
DBP (p. 4), Darach Energy Consulting Services (pp. 2-15)	<p>DBP indicated that the Rate of Return Guideline review should incorporate a specific review of inflation and the use of default parameters for all service providers.</p> <p>Darach Energy Consulting indicated that the next Guideline should incorporate a broader review which includes the purpose of the Guideline, the effectiveness of the NER, NGR, NEL and NGL. It also suggests that the 2 year review deadline extension should be used collect additional data to better inform that regulatory determination process.</p>	<p>The issues raised by stakeholders relate either to specific content within the Rate of Return Guideline, or the broader regulatory determination process.</p> <p>This rule change process is about extending the guideline review process in light of the outstanding FCA matters. Accordingly, the issues raised are not within scope.</p>
Ausgrid (p. 1)	Ausgrid recommended that an additional 2-3 week extension be considered for the publication of this final rule determination in order to allow for further consultation.	The Commission considered that the final rule determination could be made within the timeframes allotted. A two week extensions had already been granted to better consider submissions to the consultation paper.
Essential Energy (p. 1)	Essential Energy suggested that the Commission's preferred transitional provisions be updated to ensure that the 2013 Guideline also applies to subsequent merits or judicial review processes for affected service providers.	The Commission understands that any merits or judicial review processes would consider the relevant information at the time of the AER's determination. Accordingly, the Commission does not consider it necessary to include this in transitional provisions.
Endeavour Energy (p. 1)	Endeavour Energy view that consideration should be given to better align the timing of all service providers' regulatory processes to ensure that the timing issues can be resolved.	This rule change process is about extending the guideline review process in light of the outstanding FCA matters. Accordingly, the issues raised are not within scope.

B Legal requirements under the NEL and NGL

This appendix sets out the relevant legal requirements under the NEL and the NGL for the Commission to make this final rule determination.

B.1 Final rule determination

In accordance with ss.102 and 103 of the NEL and ss. 311 and 313 of the NGL, the Commission has made final rules and this accompanying final rule determination in relation to the rules proposed by the AER.⁷⁴

The Commission's reasons for making these final rules and this final rule determination are set out in Chapters 3 to 5.

The National Electricity Amendment (*Rate of Return Guidelines Review*) Rule 2016 No. 9 and National Gas Amendment (Rate of Return Guidelines Review) Rule 2016 No. 2 are published with this final rule determination. These rules commence on 20 October 2016. The rules are the same as the rules proposed by the proponent with additional transitional provisions in the NER. The key features of the final rules are described in section 2.4.

B.2 Commission's considerations

In assessing the rule change request the Commission considered:

- the Commission's powers under the NEL and NGL to make the rules;
- the rule change request;
- submissions received during consultation; and
- the Commission's analysis as to the ways in which the proposed rules will or are likely to, contribute to the achievement of the NEO and NGO.

There is no relevant Ministerial Council on Energy (MCE) statement of policy principles for this rule change request.⁷⁵

B.3 Commission's power to make the rule

The Commission is satisfied that the rules fall within the subject matter about which the Commission may make rules. The final rules falls within s. 34 of the NEL and s. 74 of the NGL as they relate to the activities of persons (including registered participants) participating in the national electricity and gas markets, or involved in the operation of the national electricity and gas systems.

Further, the final rule under the NER falls within the matters set out in Schedule 1 to the NEL as it relates to transmission and distribution system revenue and pricing because it

⁷⁴ Under s. 103 (3) of the NEL the rule that is made in accordance with s. 103(1) need not be the same as the draft of the proposed rule to which a notice under s. 95 relates or the draft of a rule contained in a draft rule determination.

⁷⁵ Under s. 33 of the NEL the Commission must have regard to any relevant MCE statement of policy principles in making a rule.

relates to the regulatory determination process for transmission and distribution network service providers, and regulatory economic methodologies. In addition, the final rule under the NGR falls within the matters set out in Schedule 1 to the NGL as it relates to regulatory economic methodologies, and economic regulatory function or powers of the AER, because it relates to the regulatory access arrangement processes for distribution pipeline service providers.

B.4 Other requirements under the NEL and NGL

In applying the rule making test in s. 88 of the NEL and s. 291 of the NGL, the Commission has:

- taken into account the revenue and pricing principles as required under s. 88B of the NEL as the rule change request relates to the regulatory determination process for transmission and distribution network service providers,, and regulatory economic methodologies; and
- taken into account the revenue and pricing principles as required under s. 293 of the NGL as the rule change request relates to regulatory economic methodologies, and economic regulatory function or powers of the AER .

The form of regulation factors do not apply to this rule change request, and therefore the Commission has not been obliged to take them into account.

The National Gas Amendment (Rate of Return Guidelines Review) Rule 2016 No. 2 applies in Western Australia as it falls within the subject matter about which the Commission may make rules under the *National Gas Access (WA) Act 2009*.

The National Electricity Amendment (Rate of Return Guidelines Review) Rule 2016 No. 9 applies in the Northern Territory because it is an amendment to Chapter 6 of the NER which has been adopted by the Northern Territory.

The *National Electricity (Northern Territory) (National Uniform Legislation) Act 2015* allows for an expanded definition of the national electricity system in the context of the application of the NEO to rules made in respect of the Northern Territory, as well as providing the Commission with the ability to make a differential rule that varies in its terms between the national electricity system and the Northern Territory's local electricity system.

The Commission has considered whether a differential rule is required for the Northern Territory electricity service providers and concluded that it is not required in this instance.

