

THE AUSTRALIAN ENERGY MARKET COMMISSION

REVIEW OF THE ELECTRICITY TRANSMISSION REVENUE AND PRICING RULES

INITIAL CONSULTATION: SCOPING PAPER

July 2005

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Introduction

The Australian Energy Market Commission (AEMC or Commission) has been established as part of the energy reform process undertaken by the Ministerial Council on Energy (MCE). Its responsibilities include:

- making and amending the National Electricity Rules (Rules); and
- carrying out reviews of the Rules as part of its market development role in the National Electricity Market (NEM).

One of the first projects to be undertaken by the AEMC is to review, and as required, rewrite the Rules for electricity transmission revenue and price regulation. This AEMC-initiated Rule change must be completed so that new Rules can be in place on or before 1 July 2006, another date as required by regulations.

Recognising the importance and size of the Review, the Paper proposes for comment the desirability of undertaking a two stage process with the first stage (revenue regulation) to be completed by 1 July 2006, and the second stage (price regulation) to be completed by 1 January 2007. Adoption of this extended process would require approval by the MCE and regulations to extend the completion date.

Transmission services are essential to the efficient, reliable operation of the NEM. The transmission network connects remotely located generation to customer load centres throughout the interconnected NEM. It involves long-term investments in the fixed assets which must be priced efficiently to remunerate network owners and to provide appropriate signals for lumpy investments in network expansion and the location of additional generation capacity.

In that broader context, a central issue for this Review will be to assess the scope and form of transmission regulation that will best contribute to the achievement of the NEM objective – an efficient, safe and reliable electricity system. In conducting the Review, the Commission will also give careful consideration to the implications for electricity transmission price regulation of the current public debate about the capacity and reliability of Australia's infrastructure services and the role of regulation in facilitating timely and efficient infrastructure investment.

A Review of the revenue and price regulation Rules for transmission raises a number of complex issues, many of which interact with other parts of the NEM, including the operation of the wholesale energy market. This Review will need to take many of these issues into account while remaining focused on its central purpose. In this regard, the NEL provides legislative guidance on the scope of the transmission revenue and pricing Rules that are the subject of this Review

In this early stage of the process, the Commission has adopted a wide and deliberately open stance on the scope of this Review. The purpose of this Scoping Paper is to seek comments from market participants and other stakeholders on the scope of this Review

and the key issues relevant to it, in light of the statutory requirements of the NEL. To provide a basis for those comments, the Commission has identified in this paper a preliminary indication of the areas and issues that it considers to be either directly or indirectly relevant to this Review. Responses will assist the AEMC in refining the scope of the Rule making process.

The Paper sets out a proposed timetable for the Review which reflects this two-staged process. Interested stakeholders are invited to make comment on the scope of this Review. Submissions should be received by 5 pm on 19 August 2005. Submissions can be sent electronically to submissions@aemc.gov.au or by mail to:

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1. Market and policy context for the Review

1.1. *Role and importance of electricity transmission*

The electricity transmission network is fundamental to the efficient, reliable and safe operation of the NEM.

By linking electricity buyers and sellers across the interconnected NEM, the transmission network facilitates competition and more efficient resource use in the electricity wholesale and retail markets. Efficient pricing, use of and investment in transmission services contributes to the delivery of more reliable and lower cost energy supplies to end use customers by lowering the cost of both generation and transmission services and increasing the choice of supply options.

The costs and prices of transmission services are also important in determining the most efficient mix of transmission and non-transmission services.

There has been a long-running debate on the most appropriate market arrangements for transmission services within the NEM. This debate encompasses issues such as whether there should be market-based transmission arrangements rather than a common carriage regime, and the appropriateness of the adoption of firm access rights (either physical or underpinned by a form of financial transmission rights). Addressing many of the issues raised in this debate is beyond the scope of the current Review. Nevertheless, in conducting this Review, the Commission will need to take account of the wider debate and should seek to develop Rules that, as far as possible where appropriate, are robust enough to accommodate future reform of electricity transmission arrangements in the NEM.

1.2. *Role of regulation*

Electricity transmission involves long term investments in fixed assets whose services must be priced efficiently to remunerate network owners and to provide appropriate signals for timely investment in network expansion and the location of additional generation capacity. However, the scale economies and fixed long term assets involved in the provision of transmission services also create barriers to entry for other service providers, which confer substantial market power on network owners. This gives rise to a public policy requirement for on-going regulation of the revenues and prices of transmission services.

The economic regulation of transmission services must be cognisant of the interaction between transmission services and effective competition in the wholesale exchange including investments in non-network energy solutions.

The AEMC is keen to ensure that the Review takes into account the broader impact of transmission services and pricing on the competitiveness and efficiency of the NEM as a whole. It also recognises that a practical and cost effective regulatory framework for transmission services is essential to achieving the market objective of an efficient, safe, reliable and secure electricity system.

1.3. Investment in infrastructure

The Commission is mindful that this Review is taking place against the backdrop of significant public debate on the incentives for infrastructure investment¹. There is a challenge to ensuring that businesses have appropriate incentives and sufficient certainty to undertake long term efficient investment decisions, while limiting the ability of infrastructure service providers to create inefficiencies by exercising market power. The Rules should provide the appropriate signals for efficient investment and a competitive NEM. This is embodied in the NEM objective with its reference to the ‘long-term’ interests of consumers and it explicitly refers to ensuring the reliability and security of supply of electricity, alongside price and quality.

1.4. Regulation of distribution

The AEMC is required, specifically, to review the Rules for regulation of electricity transmission revenues and prices. At this stage the Commission has not been asked to review Rules governing electricity distribution regulation. However, there are aspects of economic regulation where a high degree of similarity between transmission and distribution businesses can be expected. The Commission is also mindful that there are differences in the characteristics of electricity transmission and distribution that are likely to warrant ongoing differences in the Rules applicable to each.

1.5. Previous reviews

The National Electricity Code Administrator (NECA) conducted an extensive review of electricity transmission and distribution pricing over 1997-1998, reporting in July 1998². This review incorporated the views of working groups and submissions from stakeholders and made recommendations in relation to:

- The objectives for a transmission pricing regime;
- Who should pay for shared transmission costs;
- The appropriate form of charges;

¹ See for example, Exports and Infrastructure Taskforce, *Australia's Export Infrastructure*, Report to the Prime Minister, Canberra, May 2005

² NECA, *Transmission and Distribution Pricing Review*, Final Report, July 1999, Volumes I-III plus appendices

- Rules for market-driven transmission investment;
- Prudent discounts to prevent inefficient network by-pass; and
- The pass-through of rebates to embedded generators.

NECA's proposals were submitted to the ACCC for authorisation in mid-1999. In late 2000, the ACCC published a Draft Determination that accepted a number of NECA's proposals. However, the ACCC rejected NECA's approach on the key issue of the form of customer shared network charges and went on to set out a number of principles for an appropriate charging methodology³.

The ACCC's Final Determination in 2001 moved away from requiring NECA to develop an alternative methodology and instead required NECA, as a condition of authorisation, to further review whether other reforms such as a more refined regional pricing structure would obviate the need for a more complex transmission pricing regime⁴.

Over this time, NECA had also published a draft report as part of its Review of the Integration of the Energy Market and Network Services (RIEMNS), in which it recommended a move to a different set of regional boundary criteria that would have had the likely effect of increasing the number of NEM regions from five to 12-15⁵. However, following the NEM Ministers' request for a moratorium on regional boundary changes, a final report on the regional boundary criteria aspect of the RIEMNS was not published..

A number of smaller transmission pricing-related reforms followed the ACCC's Final Determination on network pricing. The ACCC published guidelines on prudent discounts of transmission charges to discourage inefficient network by-pass⁶ and NECA undertook some preliminary work on a 'beneficiary pays' approach to pricing for new transmission investment, involving generator payments for new transmission investment⁷. However, the work on beneficiary pays did not proceed to final recommendations and Code change proposals.

In 2003, the MCE appointed consultants, the Firecone consultancy, to produce a report on the regulatory and institutional framework for electricity transmission⁸. This report largely dealt with the management of transmission congestion and TNSP roles and obligations, but as noted above, these matters strongly interact with regulated transmission pricing.

³ ACCC, *Amendments to the National Electricity Code, Network Pricing and Market Network Service Providers*, Draft Determination, December 2000. See, specifically, conditions C4.1-C4.3, pp. 29-30

⁴ ACCC, *Amendments to the National Electricity Code, Network Pricing and Market Network Service Providers*, Final Determination, September 2001. See, specifically, conditions C4.1-C4.2, pp. 34-35

⁵ NECA, *The Scope for Integrating the Energy Market and Network Services*, Summary Draft Report and Draft Reports Volumes I-IV, October 2000

⁶ ACCC, *Guidelines for the Negotiation of Transmission Discounts*, Decision Paper and guideline document, both May 2002

⁷ NECA, *Beneficiary Pays: A Framework for Implementation*, Issues Paper, March 2002

⁸ Firecone, *Regulatory and Institutional Framework for Transmission*, Final Report, November 2003

The MCE then appointed consultants, Charles River Associates, to prepare a number of reports on the management of electricity transmission congestion and regional boundaries in the NEM. But again, these did not directly deal with regulated transmission pricing⁹.

In October 2004, the MCE published a Consultation Paper on the structure of regional boundaries¹⁰ and in May 2005, a Statement on Electricity Transmission¹¹.

The AEMC will, where appropriate, have regard to the aspects of these earlier reviews that are relevant to the purpose and scope of the current Review.

1.6. ACCC's Statement of Regulatory Principles

In December 2004, the ACCC published its *Statement of principles for the regulation of electricity transmission revenues* (SRP), which revised significantly the regulatory approach set out in its 1999 *Draft statement of principles for the regulation of transmission revenues* (DRP). The 2004 SRP reflects the approach to transmission revenue regulation adopted by the ACCC.

The AEMC recognises that the SRP is the product of extensive consultation and will have regard to the SRP and the associated consultation process in developing the Rules for electricity transmission regulation.

1.7. MCE statement on electricity transmission

The MCE recently issued a Statement on NEM Electricity Transmission. This Statement has not been gazetted and so is not a formal MCE Statement of Policy Principles with statutory status under the NEL. However, it does identify a number of matters of relevance to the development of the Rules for the regulation of electricity transmission revenue and price, including the following:

- The AEMC will be requested to investigate the merits for removing stranding risk for electricity transmission investments that pass the Regulatory Test¹²; and
- The further development of an electricity transmission performance incentive regime will be a matter for the AEMC and the AER¹³.

⁹ See CRA, *NEM – Transmission Region Boundary Structure*, Consultation Draft, September 2004; CRA, *NEM Regional Boundary Issues: Theoretical Framework Report*, Final Report, September 2004; CRA, *NEM Regional Boundary Issues: Modelling Report*, Final Report, September 2004

¹⁰ MCE Standing Committee of Officials, *National Electricity Market: Regional Structure Review*, Consultation Paper, October 2004

¹¹ MCE *Statement on NEM Electricity Transmission*, May 2005

¹² Ministerial Council on Energy Statement on NEM Electricity Transmission, May 2005, p.2

These matters are discussed in more detail below.

1.8. Interaction with other energy reform programs

There are a number of energy reform programs taking place concurrently with this Review. The Commission is mindful of these areas of work and their possible relationship to any Rule changes arising from this process. They include:

- The MCE's wider and ongoing energy market reform program;
- The response by the MCE to the Productivity Commission's recommendations in relation to the gas access regime and ongoing gas reforms¹⁴;
- The development by the MCE of principles for the Regulatory Test for new electricity transmission investment¹⁵;
- The MCE review of regional boundary structures and the criteria that should apply for amending boundaries¹⁶;
- The consideration by the MCE of the role of merits review¹⁷;
- Reliability Panel work streams in relation to the review of the system reliability standard and review of Schedule 5.1 of the Rules.

¹³ Ibid p.3

¹⁴ MCE Communiqué, May 2005

¹⁵ MCE Statement on NEM Electricity Transmission, May 2005

¹⁶ MCE Statement on NEM Electricity Transmission, May 2005

¹⁷ MCE Communiqué, May 2005

2. The NEL requirements

This section of the Scoping Paper sets out the relevant statutory context in which the AEMC must make the transmission revenue and pricing Rules. A number of preliminary observations are relevant.

Firstly, the AEMC is bound by the legal framework in the NEL. This statutory framework prescribes:

- The consultation process for assessment and making of changes to the National Electricity Rules (the Rules);
- The general subject matter of the Rules and the subject matter for the transmission revenue and pricing Rules that are initiated by the AEMC and must be made on or before 1 July 2006; and
- The powers of the Australian Energy Regulator (AER), both procedural and substantive, in carrying out its role in economic regulation of electricity transmission in accordance with the Rules.

Secondly, the NEL does not expressly require the AEMC to carry out a statutory review¹⁸ prior to the commencement of the formal Rule making process. The timetable set by the NEL (for Rules by 1 July 2006) makes a full statutory review (which would include a report to the MCE), impractical. In addition, the transmission revenue and pricing Rules are an AEMC initiated Rule change proposal¹⁹. Therefore, the AEMC proposes that in the *development* of the Rule change proposal, it will be consulting broadly as set out in section 2 of this paper. For simplicity, the term “Review” is used throughout this paper to refer to the preliminary consultation and formulation of the Rule change proposal.

Thirdly, in relation to the Rules for setting transmission determinations (located currently at Chapter 6 Part B of the Rules), the subject matter of those Rules is prescribed by the NEL. Therefore, the task for the Scoping Paper is to formulate, by a consultation process with stakeholders, the factors relevant in developing a Rule change proposal for each of those matters (see section 6 of this paper).

Finally, while the NEL is relatively expansive on the regulation of transmission revenues required to finance the provision of transmission services, it provides less specific guidance about which aspects of transmission pricing ought to be the subject of Rules. The NEL provides a general statement of the subject matter of the Rules for regulation of transmission pricing (which are located currently at Chapter 6 Part C of the Rules).

Section 7 of this paper identifies the matters currently covered in Chapter 6 Part C of the Rules and seeks comment on other factors that may be relevant in developing a Rule change proposal for the regulation of transmission pricing.

¹⁸ See s.45 NEL

¹⁹ See s.35(2) & s.91(2)NEL

2.1. The NEM objective and Rule making test

The NEL sets out the overall objective for the national electricity market (the ‘NEM objective’)²⁰:

“The national electricity market objective is to promote efficient investment in, and efficient use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system.”

The NEL obliges the AEMC to be guided by the NEM objective. The AEMC must have regard to the objective in performing *any* of its functions or powers generally including the development, assessment and determination of a Rule change proposal.

The NEL also sets out the Rule making test that must be applied by the AEMC²¹, which states:

“(1)The AEMC may only make a Rule if it is satisfied that the Rule will or is likely to contribute to the achievement of the national electricity market objective.

(2)For the purposes of subsection (1), the AEMC may give such weight to any aspect of the national electricity market objective as it considers appropriate in all the circumstances, having regard to any relevant MCE statement of policy principles.”

The AEMC is empowered²² to consolidate requests for Rule changes that it considers cover the same or related subject matters. Should such a request be received during the period of the development and determination of the transmission revenue and pricing Rules, the AEMC could treat these as part of the wider process.

2.2. NEL requirements for the subject matter of the electricity transmission revenue and pricing Rules

The electricity transmission revenue and pricing Rules that are the subject of this Review have a number of unique features when compared to the other Rules made under the NEL.

Firstly, the AEMC has a mandatory duty to make the transmission revenue and pricing Rules initially by 1 July 2006, and an additional ongoing obligation to ensure that the Rules at all times continue to cover the required minimum matters as set out in the NEL²³.

²⁰ See s 7 NEL

²¹ See s 88 NEL

²² See s 93 NEL

²³ See s. 36 NEL.

Secondly, the NEL²⁴ places express obligations (“the s.35(3) matters”) on the AEMC to ensure that the transmission revenue and pricing Rules:

- a. Provide a reasonable opportunity for a regulated transmission system operator to recover the efficient costs of complying with a *regulatory obligation*²⁵;
- b. Provide effective incentives to a regulated transmission system operator to promote economic efficiency in the provision by it of services that are the subject of a transmission determination, including:
 - i. The making of efficient investments in the transmission system owned, controlled or operated by it, and used to provide services that are the subject of a transmission determination; and
 - ii. The efficient provision by it of services that are the subject of a transmission determination;
- c. Require the AER, in making a transmission determination, to make allowance for the value of assets forming part of a transmission system owned, controlled or operated by a regulated transmission system operator and the value of proposed new assets to form part of that transmission system that are, or are to be, used to provide services that are the subject of a transmission determination; and
- d. Require the AER to have regard to any valuation of assets forming part of a transmission system owned, controlled or operated by a regulated transmission system operator applied in any relevant determination or decision.

Thirdly, the s.35(3) matters mirror the duties imposed directly on the AER as to the manner in which the AER must carry out its economic regulatory functions²⁶, so that the Rules must be consistent with those obligations.

Fourth, the power to make Rules for the NEM is expressed at both a general level (in s.34 of the NEL²⁷), and also at a specific level in the matters listed in Schedule 1 to the NEL²⁸. The subject matters for the transmission determinations and pricing Rules are set out in matters 15-24 of Schedule 1 to the NEL²⁹ (“the 15-24 matters”).

Sections 6 and 7 of this paper focus on the considerations that appear to the Commission to be relevant to the development of the Rules in respect of both the 15-24 matters and the s.35 (3) matters.

²⁴ See s.35(3) NEL

²⁵ See s.2.definitions of regulatory obligation, the full text is at Attachment 1

²⁶ See section 2 (definitions – AER economic regulatory function or power) & sections 15 & 16 NEL

²⁷ See full text of s.34 at Attachment 2

²⁸ See s.34(1) and (2)

²⁹ See full text of matters 15-24 at Attachment 3

2.3. *Transitional arrangements*

The NEL permits the Rules to contain savings and transitional provisions consequent on the making or amending of the Rules³⁰.

The Commission expects that transitional arrangements may be needed as a consequence of the transmission revenue and pricing Rules. The Commission notes that the existing Rules provide for some constraints on changes in the structure of transmission price charges³¹.

The Commission invites comment on the inclusion of any issues that may relate to savings and transitional arrangements.

³⁰ See s.34(3)(p) NEL

³¹ Rule 6.5.5

3. Issues relevant to the development of the electricity transmission revenue and pricing Rules

The scope of this Review is limited to making Rules in relation to the listed matters 15-24 in Schedule 1 to the NEL. However, the consequences of other provisions in the Rules may both affect and be affected by, the operation of the Rules dealing with the regulation of electricity transmission revenues and prices.

The Commission considers that in undertaking this Review it may need to take into account the operation of other provisions in the Rules including those referred to below, and how they may interact with the operation of the Rules dealing with the regulation of electricity transmission revenues and prices.

3.1. Chapter 5 issues

The NEL requires the Rules to provide a reasonable opportunity for a regulated transmission system operator to recover the efficient costs of complying with a regulatory obligation. This is particularly relevant to the regulatory treatment of transmission capital expenditure as a large proportion of network investment is justified on the basis of meeting regulatory obligations such as reliability criteria³². More generally, a range of “regulatory obligations” in the Rules in Chapter 5 influence the amount of money transmission companies must spend. These include:

- The Regulatory Test;
- Reliability Criteria and Technical Standards;
- System Standards;
- Network Performance Requirements; and
- Network planning and performance.

The Commission invites comment on the relevance of each of these Rules to this Review and whether there are other Rules which are beyond the scope of this Review but which may be relevant to it.

³² See CRA, *NEM – Transmission Regional Boundary Structure, Consultation Report*, September 2004, p.3; Firecone, *Regulatory and Institutional Framework for Transmission*, Final Report, November 2003, p.10

3.2. Market Network Service Providers (MNSP)

The Rules relating to MNSP's are not within the scope of this Review.

However, as MNSPs can potentially be both a complement and substitute to regulated transmission networks, the pricing of the regulated network is likely to impact on the opportunity for, and value of, these investments. Therefore, the Commission recognises the need to consider this issue when examining the specific matters in the Review.

The Commission invites comment on whether, and to what extent the Rules that provide for non-regulated transmission systems may be relevant to specific matters in this Review.

4. Economic regulation of electricity transmission revenue

4.1. *Why regulate electricity transmission*

As already noted earlier in this Scoping Paper, electricity transmission is, in many cases, a natural monopoly. Further, the transmission system is a fundamental part of the NEM because it brings together generation and load. The generators and retailers both operate in a competitive (or potentially competitive) environment, and the effective and efficient functioning of the transmission system is crucial for efficient outcomes in those markets, and for meeting the market objective of a safe, reliable and secure electricity system.

The strength of the externalities involved in electricity transmission and the market power arising from the technical conditions of supply of transmission services mean that regulation of transmission continues to be important for the efficient operation of the whole of the wholesale market. However, there are questions around the scope and form of the regulation of transmission.

The framework established to guide this Review appears to involve a presumption that regulation of electricity transmission revenues, or of the prices that determine revenues, should continue. The explicit reference in the NEL to the asset base, depreciation, return on investment and operating expenditure appears to imply a presumption that the building block approach may be retained as the underlying methodological approach.

Nevertheless, an important task falling within the scope of the Review will be to establish the appropriate scope of regulation. Some electricity transmission services – such as generator and MNSP access charges – are currently not subject to regulation, and so the costs and revenues attributable to these services fall outside the existing revenue determination process. An important question for this Review will be to establish those services that fall within the scope of those subject to revenue or price controls, and those that do not.

The existing Rules provide that transmission services are subject to revenue regulation only, an arrangement that contrasts with that for distribution and many other infrastructure services that are subject to price or revenue cap regulation. An important question falling within the scope of this Review will be whether the existing revenue cap approach should be maintained, or whether the market objective may be furthered by a price based approach to the control of transmission services.

The market objective will guide the Commission in making Rules and in establishing the principles for the AER to apply in economic regulation.

4.2. Form of regulation

The Commission must make Rules in relation to the mechanism or methodologies for the derivation of the maximum allowable revenue or prices to be applied by the AER in making a transmission determination³³.

The Commission notes that one element of the wider debate on infrastructure regulation is the circumstances under which it may be appropriate to adopt more ‘light-handed’ regulatory regimes, such as price monitoring or approaches that involve the use of indexes of total factor productivity³⁴.

The Commission invites comment on whether, in the light of the NEM objective and the requirements of s.35(3), this Review should consider alternative approaches to the current CPI-X building block approach.

4.3. Mechanism for establishing the revenue requirement

Matter 15 in Schedule 1 to the NEL requires the Commission to develop Rules covering the regulation of revenues for transmission system operators. It also contains specific provisions in relation to Rules covering particular elements of the revenue requirement, as noted below.

The ACCC’s 2004 SRP reflects the current regulatory approach to addressing these and other elements of the determination of electricity transmission revenue requirements. As noted in section 1 of this paper, the Commission will have regard to the SRP and the consultation associated with its development in the course of conducting this Review.

4.3.1. Asset base and criteria for determining efficient investment

The NEL requires the Rules to:

- cover the valuation, for the purposes of making a transmission determination, of assets forming part of a transmission system and of proposed new assets (matter 21 in Schedule 1 to the NEL);

³³ Item 20 in Schedule 1 to the NEL

³⁴ See, for example, ABARE, Exports and Infrastructure Taskforce, *Australia’s Export Infrastructure*, Report to the Prime Minister, Canberra, May 2005, pp.3-4 and 38-46; Productivity Commission, Review of the Gas Access Regime, Final Report, 10 August 2004

- cover the assessment or treatment by the AER of investment in transmission systems, including the economic framework and methodologies to be applied by the AER in carrying out this assessment (matters 18 and 19 in Schedule 1 to the NEL); and
- require the AER to make allowance for the value of existing and new transmission assets in making a transmission determination (s.35(3)(c)).

There is also an explicit requirement in the NEL (s.35(3)(d)) for the Rules to require the AER to have regard to any previous valuations of a transmission system operator's assets, including those made under the National Electricity Code or jurisdictional legislation.

As discussed in the previous section, the NEL requires that the Rules provide a reasonable opportunity for a regulated transmission system operator to recover the efficient costs of complying with regulatory obligations (s.35(3)(a)). Such regulatory obligations include planning and service standard requirements and are set out in Chapter 5 of the Rules (and accompanying schedules).

It appears to the Commission that the review of the Rules for the treatment of new capital investment should consider the relative merits of both *ex ante* and *ex post* approaches to determining capital allowances, and the circumstances under which either or combinations of these approaches may be appropriate.

As noted in section 2 of the Paper, this Review is taking place in the context of a wider debate about the appropriate role of and market arrangements for, electricity transmission in the NEM. The outcome of that wider debate will have significant implications for the behaviour of regulated transmission businesses and, by extension, the appropriate approach to be taken to regulating those businesses. For example, any move towards requiring electricity transmission businesses to provide firm access can be expected to significantly affect the approach those businesses take to planning and investment. As already noted, the Commission's intended approach in this Review is to seek to develop Rules that, where possible, are flexible enough to accommodate alternative outcomes from the wider debate on the appropriate market arrangements for transmission.

A number of issues may need to be considered as part of this Review, including:

- The interaction between establishing revenue requirements, the Regulatory Test and the proposed requirement to investigate removing stranding risk for transmission investment that passes the Regulatory Test³⁵;
- The relative merits of both *ex ante* and *ex post* approaches to new capital investment in determining capital allowances, and the circumstances under which either or combinations of these approaches may be appropriate; and
- The valuation of assets in the existing asset base. The ACCC's original Draft Statement of Regulatory Principles proposed the periodic application of a depreciated optimised replacement cost (DORC) valuation process to the

³⁵ MCE Statement on Transmission, May 2005

regulated asset base, while the SRP moved to a ‘line-in-the-sand’ roll forward approach to valuing the asset base which removes the risk of asset optimisation.

The Commission is considering including in the Review regulatory approaches that include the range of issues outlined above, however there is a question as to whether additional issues should be considered as part of those the Review.

The Commission invites comment as to whether there are any other issues that need to be considered in this Review in addition to those identified above.

4.3.2. Depreciation, return on investment and operating expenditure

Item 22 in Schedule 1 to the NEL requires the Rules to cover the determination by the AER of:

- A depreciation allowance;
- Operating costs of the regulated transmission system operation; and
- An allowable rate of return on assets.

The Commission is considering including in the Review regulatory approaches that include these cost elements. However, there is a question whether additional cost elements should be considered as part of the Review.

In addition to these factors, this Review may need to consider whether Rules will need to be developed in relation to allowable cost pass through mechanisms, since the presence of such mechanisms can affect the determination of operating costs, the risk exposure of the regulated businesses and the allowable rate of return on assets. The development of such Rules would be consistent with the general provision of Schedule 1(15) to develop Rules in relation to the revenues earned by transmission operators.

The Commission invites comment on whether there are costs additional to those outlined above that should be considered as part of the Review.

4.3.3. Incentive mechanisms

Item 23 in Schedule 1 to the NEL requires Rules to provide incentives for regulated transmission system operators to make efficient operating and investment decisions. Section 35(3)(b) of the NEL also requires that the Rules provide effective incentives for efficient investment and service provision.

The provision of commercial incentives for transmission system operators to achieve cost efficiencies, to make timely, efficient investments and to maintain the longer-term reliability and availability of transmission services is a central element of effective economic regulation. The design and provision of effective incentive regimes can be a cost-effective alternative to more information intensive approaches to regulation. The incentive approach can encourage the delivery of more efficient and reliable service outcomes while avoiding the cost and intrusiveness of more direct forms of regulation.

The MCE Statement on NEM Electricity Transmission refers to the further development of an incentive scheme relating to the performance of the transmission system in relation to the availability of transmission.

The Commission is mindful of the trade-offs between cost (and therefore price) and service quality.

The Commission invites comment on what issues should be included when considering incentives for regulated transmission systems to make efficient operating and investment decisions.

4.3.4. Non-transmission alternatives

The economic regulation of electricity transmission is likely to impact on decisions about investment in new transmission infrastructure, and whether in particular circumstances, future capacity expansion or system constraints can be addressed more efficiently by alternatives to transmission investment.

Whilst recognising the wide range of potential alternatives to investment in transmission, the Commission is interested in understanding where existing Rules may positively or negatively, impact on the consideration of non transmission alternatives.

The Commission invites comment on what issues are relevant when considering non-transmission alternatives as part of this Review.

5. Economic regulation of electricity transmission prices

5.1. *Statutory Rule making power for electricity transmission pricing*

In contrast to revenue regulation, where the NEL sets out the specific matters about which Rules must be made, there is only a general statement of the subject matter of the Rules in relation to electricity transmission pricing.

In light of this, the scoping task for transmission pricing requires the Commission to identify relevant subject matters within this general statement.

In order to determine the scope of transmission pricing issues, the Commission intends to:

- Examine the matters relating to transmission pricing in the existing Rules;
- Have regard to the number of reviews into electricity transmission pricing that have already taken place; and
- Invite stakeholder comment on the matters relevant to transmission pricing.

5.2. *Why regulate electricity transmission prices and who should pay*

Earlier in this Scoping Paper, the central role of the electricity transmission system in promoting efficient, competitive outcomes in generation and retailing was highlighted as the means of achieving a safe, reliable and secure electricity system. It was also noted that the transmission system displays strong natural monopoly characteristics, which derive from significant scale economies. Left unregulated, electricity transmission operators, in pursuit of higher business value and returns, would be likely to provide a sub-optimal and inefficient level of transmission services, and to price them inefficiently. This would have adverse impacts on resource allocation and the competitiveness of electricity generation and retailing and would undermine the ability of the market to satisfy the market objective of a safe, reliable and secure electricity system.

The previous section of this Paper dealt with the need for, and approach to regulation of the revenues required to produce the efficient provision of transmission services, and the scope of the Rules that ought to be considered in that respect.. This section deals with the need for regulation of transmission prices to ensure appropriate signals for augmentation of the network, timely investment in new generation capacity and efficient outcomes in the electricity wholesale and retail markets consistent with requirements of the market objective.

In general, transmission pricing Rules need to be developed where there is a risk that inappropriate charging arrangements would create material inefficiencies. These inefficiencies could include, for example, encouraging excessive expenditure on providing transmission services or by creating unnecessary entry barriers for generators, retailers and potential competitors to the transmission service providers themselves.

The complexity of transmission pricing is a result of both the cost structure of transmission services and the economic and technical characteristics of the networks:

- Most transmission costs are fixed - only a very small percentage of costs (less than 10 per cent) are variable over a wide range of output. Most variable transmission costs are related to transportation losses, which are paid for in the energy component of a customer's bill. Even if transmission congestion costs were included as variable costs, total variable costs would still be small in relation to the fixed costs. In the presence of large fixed costs, there is a wide range of pricing outcomes that satisfy the conditions for efficient pricing. In considering the need for guidance in the Rules on how these costs are to be allocated, consideration will need to be given to what is fair, and what is most likely to promote efficient outcomes in the short and long term. There is no one correct answer on this matter, highlighting the need to consult widely on the need for, and nature of, any Rules that govern the allocation of these costs between network users; and
- Changes to the capacity and use of the network in one part of the transmission network that affects the capacity and the amenity to other users located elsewhere in network. These 'external' effects are highly complex and often very difficult to predict. Together with the large fixed costs of transmission networks, it is difficult to determine the costs a particular user imposes on both the network and other users. This makes it difficult to allocate costs to particular users in any robust manner and yet the way costs are allocated can significantly affect the economics of market entry (and exit).

These difficulties explain why there has been ongoing debate on matters such as the appropriate allocation of transmission costs between generators and market customers, on the level of cost averaging in the current pricing framework and on the appropriate price discounts for users who have genuine options for by-passing the transmission system. These are matters that the AEMC believes are amongst the pricing matters that need to be considered as part of this Review.

5.3. Matters in existing Rules on electricity transmission pricing

This section sets out the matters that are covered under the current Rules.

The Commission invites comment as to whether the Rules appropriately cover the scope of matters that ought to be taken into consideration in this Review, and if not, what additional matters, or fewer matters, should be covered under the Rules.

5.3.1. Transmission pricing arrangements

The current Rules set out a number of objectives and principles for the regulation of transmission pricing³⁶. As noted earlier in this Paper, the Commission expects to simplify and clarify the regulatory arrangements in the course of this Review. This process of simplification and clarification will aim to remove or revise any overlaying or potentially inconsistent objectives (separate to the NEM objective).

The Commission invites comment on whether it should be seeking to simplify and clarify the transmission pricing objectives and principles in the course of the Review.

5.3.2. Range of charges

The existing Rules outline methodologies or principles for the calculation of the following range of charges³⁷:

- Entry charge – payable by generators for connection to the transmission network;
- Exit charge – payable by ‘off take’ customers (distribution network service providers (DNSPs) and large loads) for connection to the transmission network;
- Negotiated use of system charges – payable by generators and MNSPs to recover the costs of upstream or downstream network augmentation and extension necessitated by their connection;
- Customer usage charge – payable by off take customers on a locational basis in respect of some of the costs of the shared transmission network;

³⁶ Rule 6.1.1

³⁷ Rules 6.5-6.5.6, 5.5(f)(2) and 5.5A(g)(2)

- Customer general charge – payable by off take customers to recover regulated transmission system operators’ outstanding revenue requirements in respect of the shared network not recovered through other charges; and
- Common service cost – payable by off take customers to recover transmission network shared (‘common’) services.

The Rules provide for generator and MNSP ‘access charges’ to be negotiated, but these charges are neither regulated nor is the revenue they recover part of regulated revenue³⁸.

The Rules also allow agreements for reduced transmission charges and refer to the ACCC’s “Guidelines for the Negotiation of Discounted Transmission Charges”³⁹. These Guidelines deal with the recovery of the cost of ‘prudent discounts’ on customer general charges or common service charges for customers that can demonstrate the cost of bypassing the transmission network would be less than the charges they currently pay.

The Commission invites comment on whether this Review should address the range of charges set out above.

5.3.3. TUoS rebates

The Rules provide for ‘avoided TUoS rebates’ to embedded generators. These rebates represent the transmission charges that a DNSP would have had to pay to a regulated transmission system operator *but for* the output of an embedded generator within the DNSP’s network. Although, *prima facie*, this makes the Rules surrounding TUoS rebates a matter for the distribution pricing arrangements, these rebates can be highly influential in embedded generator locational and output decisions. Since embedded generators represent a key alternative to transmission development, there is a close relationship between TUoS rebates and other aspects of the transmission regulatory regime.

The Commission invites comment on whether this Review should consider avoided TUoS rebates.

³⁸ See clauses 5.5(f)(4), 5.5A(g)(3) and 6.5.3(b)

³⁹ ACCC, “Guidelines for the Negotiation of Discounted Transmission Charges”, 3 May 2002

5.3.4. Allocation of shared network costs

The present transmission pricing arrangements recover the bulk of shared network costs through use of system charges to off take customers – DNSPs and large loads directly connected to the transmission network. As mentioned above, the Rules currently provide for generator and MNSP negotiated use of system charges, but these are intended only to reflect network augmentation costs arising (or avoided) as a direct result of connection.⁴⁰ They do not include payment by generators or MNSPs for new shared transmission investment more generally. At the same time, the Rules envisage (but do not impose) generator charges for new shared network investment⁴¹.

The Commission invites comment on whether this Review should consider the allocation of shared network costs between users of the transmission system.

5.3.5. Form of shared network use of system charges

As noted above, regulated transmission system operators can presently choose the form of shared network customer usage charge between (broadly speaking) the CRNP and modified CRNP methodologies. Schedule 6.4 of the existing Rules provides more detail on these charging methodologies.

The Commission recognises that pricing for shared transmission network assets can take a number of forms, including:

- CRNP (as currently described in the Rules);
- Modified CRNP (as currently described in the Rules);
- Locational charges and rebates (as implemented in Britain);
- LRMC (taking into account forward-looking network expansion and augmentation costs);
- ‘Causer-pays’ pricing (with current charges based on historical demand or consumption – geared towards promoting dynamic efficiency in locational decisions)⁴²; and
- Postage-stamped charges (non-locationally differentiated charges, based on the promotion of static efficiency).

⁴⁰ Rule 5.5(f)(2) and 5.5A(g)(2)

⁴¹ See Schedule 6.8

⁴² This was recently considered (but not adopted) in New Zealand, see: New Zealand Electricity Commission, *Proposed Guidelines for Transpower’s Pricing Methodology*, Consultation Paper, September 2004

A number of other options are possible and may be worth exploring.

The Commission invites comment on whether this Review should consider the methodology(ies) for determining shared network usage charges.

5.3.6. Structure of charges

At present, the Rules provide for customer shared transmission usage charges to include combinations of demand-based charges, consumption-based charges and fixed charges⁴³.

The Commission invites comment on whether this Review should consider the degree of flexibility retained by transmission system operators to determine the structure of charges, and whether alternative structures should be considered.

5.3.7. Inter-regional TUoS transfers

The existing Rules do not explicitly provide for the transfer of TUoS charges across regions where the provision of electricity by a regulated transmission system operator to a customer involves the use of an adjacent region's regulated transmission system operator's assets. However, the Rules do currently provide for agreements between regulated transmission system operators in relation to the payment of inter-regional settlement residues⁴⁴.

The Commission invites comment on whether this Review should consider inter-regional TUoS transfers.

⁴³ Rule 6.5.4(c)

⁴⁴ Rule 3.6.5(a)(5)

6. Regulatory discretion and procedural requirements

6.1. Guiding discretion - economic regulation of electricity transmission

The Rules currently governing the economic regulation of transmission were drafted in a policy and regulatory design context that gave high level guidance to the regulator with broad discretion in the economic regulation of transmission.

The Commission recognises that it should take into account:

- Clarity of content and purpose of the Rules for economic regulation of transmission;
- Predictability for transmission businesses and network users in the AER's administration of economic regulation of transmission; and
- Efficient and effective regulatory practices, including through the conferral of appropriate degrees of discretion in decision-making.

The Commission invites comment on whether this Review should consider the appropriate balance between discretion and prescription when the AER is making a transmission determination.

6.2. Guiding discretion – electricity transmission pricing

The current Rules in Chapter 6 in relation to the levying and calculation of transmission prices (Part C) are relatively formulaic. This is particularly the case with respect to the range of charges in place, the identity of the liable participants and the methodology for deriving those charges.

Despite the degree of almost formulaic prescription in the Rules, a range of ambiguities remain. For example, the boundary between connection and shared transmission assets, and hence, the coverage of connection and shared network charges, is not clear.

Further, some discretion is currently available in relation to:

- regulated transmission system operators in relation to:
 - the *form* of customer usage charges – there is a choice between cost-reflective network pricing (CRNP) and modified CRNP methodologies;
 - the *application* of the customer usage charge and general charge methodologies – regulated transmission system operators apply the methodologies themselves with little or no administrative oversight;

- the *structure* of customer usage charges – there is a choice between (and combinations of) demand-based, energy-based and fixed charges; and
- AER in relation to approval of modifications to the CRNP and modified CRNP methodologies.

The Commission invites comment on whether this Review should consider the balance between unfettered versus guided discretion and formulaic prescription of charges.

6.3. Procedural requirements for AER decision making

Item 17 in Schedule 1 to the NEL enables the AEMC to make Rules in relation to the procedures to be followed by the AER in exercising or performing an AER regulatory function or power⁴⁵.

Item 24 in Schedule 1 to the NEL enables the AEMC to make Rules in relation to the procedure that the AER is to follow in making a transmission determination. The definition of “transmission determination” in the NEL⁴⁶ covers determinations of the AER that regulate either revenue that may be earned or prices that may be charged, by a transmission system operator.

Item 24 also lists some specific minimum procedural requirements:

- The publication of notices by the AER;
- The making of submissions, including by the regulated transmission system operator to whom the transmission determination will apply and by affected Registered participants;
- The publication of draft and final determinations and the giving of reasons; and
- The holding of pre-determination conferences.

The matters that may be relevant to the formulation of Rules in relation to AER procedure include:

- Timeframes for the conduct of a transmission determination, including provisions covering when extensions to the timeframe may be granted;
- The overall procedural model for seeking, processing, assessing and finalising a transmission determination. For example, how is a regulatory process triggered

⁴⁵ See s.2 (definition of “AER economic regulatory function or power”)

⁴⁶ See s.2 (definition of “transmission determination”) NEL

and whether the transmission system operator and the AER are operating in a “propose-respond” model or an “apply-assess” model;

- The manner in which the AER is provided with information for the purposes of its determinations;
- The treatment of confidential information by AER in the process of making a transmission determination⁴⁷;
- Any requirements/powers for the AER to publish guidelines, standards, procedures or any other document⁴⁸ in relation to the conduct of its regulatory functions for transmission; and
- Circumstances under which the AER can revoke or amend a determination, and the procedure for doing so.

The Commission invites comment on what issues are relevant when considering the process to be followed by the AER in making a transmission determination.

⁴⁷ See s.44AAF of the Trade Practices Act 1974

⁴⁸ See s. 34(3)(e)NEL

7. Timetable for consultation on making electricity transmission revenue and pricing Rules

The NEL requires the AEMC to make the transmission revenue and pricing Rules on or before 1 July 2006 or a later date as prescribed by the Regulations. However, due to the complexity and range of issues that will need to be considered, the AEMC is consulting with the MCE on the merits of adopting a two-staged approach that runs consideration of revenue requirements issues on a different timetable to that of price regulation issues. Adoption of that process would allow more time for appropriate consultation and consideration of the issues raised by market participants and all other stakeholders. It would also provide more time for consideration of the more complex and potentially controversial price regulation issues while permitting earlier completion of the Rules for revenue determination.

The two stage process, if agreed by the MCE, will meet the requirement to have Rules relating to transmission revenue requirements commence by 1 July 2006, while Rules relating to transmission pricing would be in place by 1 January 2007. Diagram 1 illustrates the two stage approach and Table 1 sets out the key public consultation dates that would be required.

The timetable set out in Table 1 accords with the Rule making procedure set out in the NEL. Attachment 3 illustrates the procedure and timeline for AEMC-initiated Rule making.

The timetable will be placed on the AEMC's website and updated regularly.

A number of additional consultation steps will be undertaken by the AEMC prior to the start of the formal Rule making process, including:

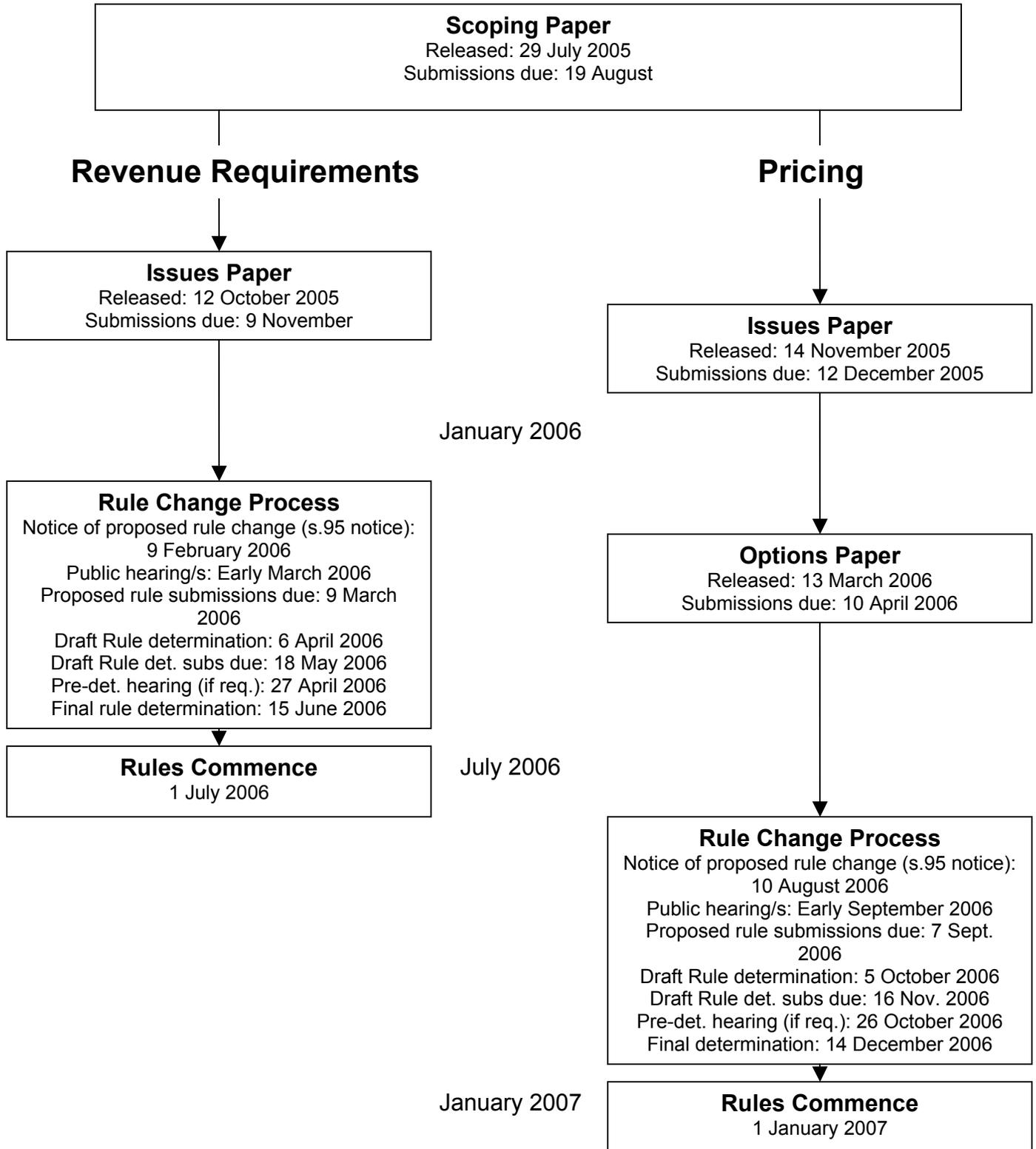
- This Scoping and Process Paper;
- An Issues Paper addressing transmission revenue requirements;
- An Issues Paper addressing transmission pricing; and
- An Options Paper addressing transmission pricing.

The Options Paper addressing transmission pricing is an additional step in the Review process. This additional step is in recognition that there is less legislative guidance in relation to pricing and that the issues surrounding pricing are more complicated and controversial.

Interested stakeholders are invited to make comment on the scope of this Review. Submissions should be received by 5 pm on 19 August 2005. The AEMC will consider these submissions in the preparation of the next step in the process – the development of the Issues Paper.

Should the two stage process be approved by the MCE, there would be two Issues Papers. The Revenue Requirements Issues Paper is expected to be released by 12 October 2005, and the Pricing Issues Paper is expected to be released by 14 November 2005.

Diagram 1 – Review Process



**Electricity Transmission Revenue and Pricing Review
Provisional Key Dates**

Action Item	Issue		Action From		Date
	Revenue Requirements	Pricing	AEMC	Stakeholders	
Release of Process and Scoping Paper for transmission revenue requirements and pricing	✓	✓	✓		29 July 2005
Submissions due on Process and Scoping Paper for transmission revenue requirements and pricing	✓	✓		✓	19 August 2005
Release of Issues Paper for transmission revenue requirements	✓		✓		12 October 2005
Submission due on Issues Paper for transmission revenue requirements	✓			✓	9 November 2005
Release of Issues Paper for transmission pricing		✓	✓		14 November 2005
Submissions due on Issues Paper for transmission pricing		✓		✓	12 December 2005
Release of notice of proposed Rule for transmission revenue requirements (s.95)	✓		✓		9 February 2006
Public hearings for transmission revenue requirements (s.98)	✓		✓	✓	Early March 2006
Submissions due on notice of proposed Rule for transmission revenue requirements (s.97)	✓			✓	9 March 2006
Release of Options Paper for transmission pricing		✓	✓		13 March 2006
Release of draft Rule determination for transmission revenue requirements (s.99)	✓		✓		6 April 2006
Submissions due on Options Paper for transmission pricing		✓	✓		10 April 2006

Action Item	Issue		Action From		Date
	Revenue Requirements	Pricing	AEMC	Stakeholders	
Deadline for interested person or body ⁴⁹ to request the AEMC to hold a pre-final Rule determination hearing (s.101)		✓		✓	13 April 2006
Submissions due on draft Rule change for transmission revenue requirements (s.100)	✓			✓	18 May 2006
Pre-determination hearing for transmission revenue requirements (if requested) (s.101)	✓		✓	✓	27 April 2006
Release of final determination for transmission revenue requirements project (s.102)	✓		✓		15 June 2006
Rules commence for transmission revenue requirements project and options paper for transmission pricing (s.104)	✓		✓	✓	1 July 2006
Release of notice of proposed Rule for transmission pricing (s.95)		✓	✓		10 August 2006
Public hearings for transmission pricing (s.98)		✓	✓	✓	Early September 2006
Submissions due on notice of proposed Rule for transmission pricing (s.97)		✓		✓	7 September 2006
Release of draft Rule determination for transmission pricing (s.99)		✓	✓		5 October 2006
Deadline for interested person or body ⁵⁰ to request the AEMC to hold a pre-final Rule determination hearing (s.101)		✓		✓	12 October 2006
Pre-determination hearing(s) for transmission pricing (if requested) (s.101)		✓	✓	✓	Before 26 October 2006
Submission due on draft Rule change for transmission pricing (s.100)		✓		✓	16 November 2006
Release of Final determination for transmission pricing (s.102)		✓	✓		14 December 2006
Rules commence for transmission pricing		✓	✓	✓	1 January 2007

⁴⁹ An interested person or body means a person or body that has made a written submission or comment under s.97 or s.100 of the NEL

⁵⁰ An interested person or body means a person or body that has made a written submission or comment under s.97 or s.100 of the NEL

Attachment 1: Relevant NEL definitions (section 2)

In this Law—

AER economic regulatory function or power means a function or power performed or exercised by the AER under this Law or the Rules that relates to the economic regulation of services provided by a regulated transmission system operator by means of, or in connection with, a transmission system and includes a function or power performed or exercised by the AER under the Rules that relates to the making of a transmission determination;

regulated transmission system operator means an owner, controller or operator of a transmission system—

- (a) who is a Registered participant; and
- (b) whose revenue or prices are regulated under a transmission determination;

regulatory obligation means, in relation to the provision by a regulated transmission system operator of services that are the subject of a transmission determination—

- (a) a transmission reliability standard;
- (b) a transmission service standard;
- (c) legislation of a participating jurisdiction or any instrument made or issued under or for the purposes of that legislation that levies or imposes a tax that is payable by a regulated transmission system operator;
- (d) legislation of a participating jurisdiction or any instrument made or issued under or for the purposes of that legislation that regulates the use of land in a participating jurisdiction by a regulated transmission system operator;
- (e) legislation of a participating jurisdiction or any instrument made or issued under or for the purposes of that legislation that relates to the protection of the environment;
- (f) legislation of a participating jurisdiction or any instrument made or issued under or for the purposes of that legislation (other than national electricity legislation or legislation or an instrument referred to in paragraphs (c) to (e)) that materially affects the provision, by a regulated transmission system operator, of services that are the subject of a transmission determination,

but does not include a penalty paid or to be paid under legislation or an instrument referred to in paragraphs (c) to (f);

transmission determination means a determination of the AER under the Rules that regulates—

- (a) the revenue an owner, controller or operator of a transmission system earns or may earn from the provision by that owner, controller or operator of services that are the subject of economic regulation under the Rules; or
- (b) the prices an owner, controller or operator of a transmission system charges, or may charge for services provided by that owner, controller or operator that are the subject of economic regulation under the Rules;

transmission reliability standard means a standard imposed by or under the Rules or jurisdictional electricity legislation relating to the reliability or performance of a transmission system;

transmission service standard means a standard relating to the standard of services provided by a regulated transmission system operator by means of, or in connection with, a transmission system imposed—

- (a) by or under jurisdictional electricity legislation; or
- (b) by the AER in accordance with the Rules.

Attachment 2: Sections 34 and 35 NEL

34—Subject matter for National Electricity Rules

- (1) Subject to this Division, the AEMC, in accordance with this Law and the Regulations, may make Rules, to be known, collectively, as the "National Electricity Rules", for or with respect to regulating—
 - (a) the operation of the national electricity market; and
 - (b) the operation of the national electricity system for the purposes of the safety, security and reliability of that system; and
 - (c) the activities of persons (including Registered participants) participating in the national electricity market or involved in the operation of the national electricity system.

Note—

The procedure for the making of a Rule by the AEMC is set out in Division 3 of Part 7.

- (2) Without limiting subsection (1), the AEMC, in accordance with this Law and the Regulations, may make Rules for or with respect to any matter or thing specified in Schedule 1 to this Law.
- (3) Rules made by the AEMC in accordance with this Law and the Regulations may—
 - (a) be of general or limited application;
 - (b) vary according to the persons, times, places or circumstances to which they are expressed to apply;
 - (c) confer functions or powers on, or leave any matter or thing to be decided or determined by—
 - (i) the AER, the AEMC, NEMMCO or a jurisdictional regulator; or
 - (ii) the Reliability Panel or any other panel or committee established by the AEMC; or
 - (iii) any other body established, or person appointed, in accordance with the Rules;
 - (d) confer rights or impose obligations on any person or a class of person (other than the AER, the AEMC or a jurisdictional regulator);
 - (e) confer a function on the AER, the AEMC, NEMMCO, or a jurisdictional regulator, to make or issue guidelines, tests, standards, procedures or any other document (however described) in accordance with the Rules;

- (f) empower or require any person (other than a person referred to in paragraph (e)) or body to make or issue guidelines, tests, standards, procedures or any other document (however described) in accordance with the Rules;
- (g) apply, adopt or incorporate wholly or partially, or as amended by the Rules, the provisions of any standard, rule, specification, method or document (however described) formulated, issued, prescribed or published by any person, authority or body whether—
 - (i) as formulated, issued, prescribed or published at the time the Rules are made or at any time before the Rules are made; or
 - (ii) as amended from time to time;
- (h) confer a power of direction on the AER, the AEMC, NEMMCO or a jurisdictional regulator to require a person conferred a right or on whom an obligation is imposed under the Rules (including a Registered participant) to comply with—
 - (i) a guideline, test, standard, procedure or other document (however described) referred to in paragraph (e) or (f); or
 - (ii) a standard, rule, specification, method or document (however described) referred to in paragraph (g);
- (i) if this section authorises or requires Rules that regulate any matter or thing, prohibit that matter or thing or any aspect of that matter or thing;
- (j) provide for the review of, or a right of appeal against, a decision or determination made under the Rules and for that purpose, confer jurisdiction on the Court;
- (k) require a form prescribed by or under the Rules, or information or documents included in, attached to or given with the form, to be verified by statutory declaration;
- (l) in a specified case or class of case, exempt—
 - (i) NEMMCO; or
 - (ii) a Registered participant or class of Registered participant; or
 - (iii) any other person or body performing or exercising a function or power, or conferred a right, or on whom an obligation is imposed, under the Rules or a class of any such person or body,

- from complying with a provision, or a part of a provision, of the Rules;
- (m) provide for the modification or variation of a provision of the Rules (with or without substitution of a provision of the Rules or a part of a provision of the Rules) as it applies to—
 - (i) NEMMCO; or
 - (ii) a Registered participant or class of Registered participant; or
 - (iii) any other person or body performing or exercising a function or power, or conferred a right, or on whom an obligation is imposed, under the Rules or a class of any such person or body;
 - (n) confer an immunity on, or limit the liability of, any person or body performing or exercising a function or power, or conferred a right, or on whom an obligation is imposed, under the Rules;
 - (o) require a person or body performing or exercising a function or power, or conferred a right, or on whom an obligation is imposed, under the Rules to indemnify another such person or body;
 - (p) contain provisions of a savings or transitional nature consequent on the amendment or revocation of a Rule.

35—Rules in relation to economic regulation of transmission systems

- (1) Subject to this section, the AEMC must make Rules for or with respect to the matters or things specified in items 15 to 24 of Schedule 1 to this Law on or before 1 July 2006 or any later date that is prescribed by the Regulations.
- (2) In making Rules as required by this section, the AEMC must treat the Rules as AEMC initiated Rules.
- (3) Rules made as required by this section must—
 - (a) provide a reasonable opportunity for a regulated transmission system operator to recover the efficient costs of complying with a regulatory obligation; and
 - (b) provide effective incentives to a regulated transmission system operator to promote economic efficiency in the provision by it of services that are the subject of a transmission determination, including—

- (i) the making of efficient investments in the transmission system owned, controlled or operated by it and used to provide services that are the subject of a transmission determination; and
 - (ii) the efficient provision by it of services that are the subject of a transmission determination; and
 - (c) require the AER, in making a transmission determination, to make allowance for the value of assets forming part of a transmission system owned, controlled or operated by a regulated transmission system operator, and the value of proposed new assets to form part of that transmission system, that are, or are to be, used to provide services that are the subject of a transmission determination; and
 - (d) require the AER to have regard to any valuation of assets forming part of a transmission system owned, controlled or operated by a regulated transmission system operator applied in any relevant determination or decision.
- (4) In this section—

relevant determination or decision means—

- (a) any previous transmission determination; or
- (b) a determination or decision under the National Electricity Code or jurisdictional electricity legislation regulating the revenue earned, or prices charged, by a regulated transmission system operator in respect of services provided by it that were regulated under the Code or that legislation.

Attachment 3

Schedule 1 to the NEL items 15-24

- 15 The regulation of revenues earned or that may be earned by owners, controllers or operators of transmission systems from the provision by them of services that are the subject of a transmission determination.
- 16 The regulation of prices charged or that may be charged by owners, controllers or operators of transmission systems for the provision by them of services that are the subject of a transmission determination, and the methodology for the determination of those prices.
- 17 Principles to be applied, and procedure to be followed, by the AER exercising or performing an AER economic regulatory function power.
- 18 The assessment, or treatment by the AER, of investment in transmission systems for the purposes of making a transmission determination.
- 19 The economic framework and methodologies to be applied by the AER for the purposes of item 18.
- 20 The mechanisms or methodologies for the derivation of the maximum allowable revenue or prices to be applied by the AER in making a transmission determination.
- 21 The valuation, for the purposes of making a transmission determination, of assets forming part of a transmission system owned, controlled or operated by a regulated transmission system operator, and of proposed new assets to form part of a transmission system owned, controlled or operated by a regulated transmission system operator, that are, or are to be, used in the provision of services that are the subject of a transmission determination.
- 22 The determination by the AER, for the purpose of making a transmission determination with respect to services that are the subject of such a determination, of
 - (a) a depreciation allowance for a regulated transmission system operator; and
 - (b) operating costs of a regulated transmission system operator; and
 - (c) an allowable rate of return on assets forming part of a transmission system owned, controlled or operated by a regulated transmission system operator.
- 23 Incentives for regulated transmission system operators to make efficient operating and investment decisions.

- 24 The procedure for the making of a transmission determination by the AER, including
- (a) the publication of notices by the AER; and
 - (b) the making of submissions, including by the regulated transmission system operator to whom the transmission will apply and by affected Registered participants (within the meaning of section 16(3)); and
 - (c) the publication of draft and final determinations and the giving of reasons; and
 - (d) the holding of pre-determination conferences.

Attachment 4: Statutory process for AEMC initiated Rule changes

