

Australian Energy Market Commission

DRAFT RULE DETERMINATION

National Electricity Amendment (Participant
derogation - ACT DNSP revenue smoothing)
Rule 2017

Rule Proponent

ActewAGL

26 April 2017

**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 (Commission) has made a draft rule in response to a request for a participant derogation from ActewAGL. The rule change request has sought to minimise price volatility for ActewAGL customers that may occur as a result of the outcome of the judicial review proceedings in relation to ActewAGL's 2014-19 distribution determination.¹

The draft rule, which is a more preferable rule, provides a process that allows for any increased or decreased revenue as a result of the outcome of the judicial review proceedings to be recovered over the current regulatory control period² and the subsequent regulatory control period.³ The process provides a mechanism that:

- minimises price volatility for consumers that may occur as a result of the outcome of the judicial review proceedings
- allows the proponents to recover the revenue that they are entitled to for the current regulatory control period.

The Commission invites submissions on this draft determination and draft more preferable rule by **20 June 2017**.

Overview of the draft rule

The draft rule incorporates elements of the proposed rule, and is designed to achieve the same outcome of minimising price volatility for ActewAGL customers. The key features of the draft rule are:

- The draft rule allows the proponent to recover any increased or decreased revenue as a result of the outcome of the judicial review proceedings over the current regulatory control period and/or the subsequent regulatory control period. The draft rule is designed to allow the proponent to recover only the revenue that it is entitled to recover, and not derive any windfall gains or losses as a result of the application of the draft rule.
- The draft rule provides the Australian Energy Regulator (AER) with the discretion to determine whether any revenue adjustments should be made in order to smooth revenue across the current regulatory control period and the subsequent regulatory control period,⁴ including the allocation of amounts between the two periods.

¹ ActewAGL applied to the Australian Competition Tribunal (Tribunal) for merits review of the 2014-19 distribution determinations under s.71B of the NEL. On 26 February 2016, the Tribunal set aside the determination and remitted them to the AER. The AER subsequently sought judicial review in the Full Federal Court of the Tribunal's decision. At the time of this draft determination's publication, the Full Federal Court has yet to decide on the matter.

² This is the period between 1 July 2014 to 30 June 2019.

³ This period will start on 1 July 2019. The length of the regulatory control period will be determined as part of the AER's distribution determination. The AER is currently consulting on the framework and approach for this distribution determination.

⁴ This is applicable where the timing of the judicial review outcome provides the opportunity for revenue adjustment to be smoothed across two regulatory control periods.

- The AER is required to make a separate decision on revenue smoothing. The decision will be given effect through the pricing proposal and distribution determination processes. The AER's determination on revenue smoothing will not affect the remaking of the 2015 distribution determination (if remaking is required), or the terms of the 2015 distribution determination (if it is affirmed or varied by the Tribunal), or the terms of the subsequent distribution determination (other than to include the variation amount).

The main differences between the proponent's proposed rule and the draft rule are as follows:

- The draft rule gives the AER greater discretion to decide how any revenue adjustments are made.
- The draft rule distinguishes more clearly between the processes that need to apply based on:
 - the outcome of the judicial review proceedings
 - the timeframe for the outcome of the judicial review proceedings.

The draft rule also sets out a process to be followed if the AER is required to reopen the distribution determination for the subsequent regulatory control period. This would be required if the outcome of the judicial review proceedings is not known in time to be incorporated when the distribution determination for the subsequent regulatory control period is issued.

Reasons for the Commission's draft determination

The Commission considers that the draft rule is in the long term interest of consumers, because it provides stable prices for consumers, outlines a mechanism that best minimises price volatility and enables ActewAGL to recover the efficient costs of providing network services.

Providing stable prices

The need for this draft rule is brought about by a set of circumstances that the National Electricity Rules (NER) do not contemplate. Significant price volatility in a short period of time has the potential to distort consumers' budgetary decisions on energy spending, as well as investment decisions on energy usage. This distortion could lead to long term inefficient outcomes for consumers.

A process that smooths any revenue increase or decrease as a result of the outcome of the judicial review proceedings is likely to lead to more stable prices which would allow consumers to make better informed decisions. The Commission considers that this is in the long term interests of consumers.

Outlining a mechanism that best minimises price volatility

The Commission considers that the draft rule is better able to minimise price volatility than the proposed rule. The draft rule avoids prescribing an adjustment process that may not be flexible enough in responding to uncertain outcomes from the judicial review proceedings.

The Commission considers that the AER, in consultation with the proponents and other relevant stakeholders, is in the best position to make informed decisions as to how to

smooth revenue across two regulatory control periods to minimise price volatility. The draft rule provides the AER with the discretion to make these decisions in accordance with a set of requirements on net present value neutrality and consultation with the proponent and stakeholders the AER considers relevant..

Enabling ActewAGL to recover the efficient costs of providing network services

As the outcome of the judicial review proceedings may not be known until after the current regulatory control period ends, the draft rule provides a reasonable opportunity for the proponents to recover the efficient costs of providing network services during the current regulatory control period and subsequent regulatory control period. The proponents will not derive any windfall gains or losses through the smoothing of revenue across two regulatory control periods.

Related rule change

Ausgrid, Endeavour Energy and Essential Energy (NSW DNSPs) submitted a joint rule change request seeking a participant derogation to provide a mechanism to similarly minimise price volatility for their customers. The draft determination in relation to NSW DNSPs' rule change request was published on the same date as this draft determination, and is available on the Commission's website.⁵

⁵ www.aemc.gov.au/Rule-changes/Participant-derogation-NSW-DNSPs-Revenue-Smoothing

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1 Rule change request and rule making process

1.1 The rule change request

On 23 September 2016, ActewAGL submitted a rule change request to the Australian Energy Market Commission (Commission) seeking a participant derogation to amend the National Electricity Rules (NER).⁶ The rule change request has sought to provide a mechanism to minimise price volatility for ActewAGL customers that may occur at the conclusion of the judicial review proceedings in relation to the ActewAGL's 2014-19 distribution determinations.⁷ The rule change request proposes to allow any required adjustments to ActewAGL's revenues for the 2014-19 regulatory control period to be recovered over two regulatory control periods.

Ausgrid, Endeavour Energy and Essential Energy (NSW DNSPs) submitted a joint rule change request seeking a participant derogation to provide a mechanism to similarly minimise price volatility for their customers on 18 July 2016. The draft determination in relation to NSW DNSPs' rule change request was published on the same date as this draft determination and is available on the Commission's website.⁸

1.2 Current arrangements and relevant background

1.2.1 Regulation of distribution network service provider revenue

As monopoly service provider, the revenue of distribution network service providers, such as ActewAGL, is regulated by the Australian Energy Regulator (AER). The AER regulates the distribution network service provider's revenue through the making of distribution determinations.⁹ A distribution determination covers a regulatory control period, which is usually a five year period.

A distribution determination is a 'reviewable regulatory decision' under the National Electricity Law (NEL).¹⁰ Parties that are affected¹¹ by the AER's distribution

⁶ A participant derogation is a rule made at the request of a person who is conferred a right, or is subject to an obligation, under the NER that exempts that person or a class of person of which that person is a member, from complying with a provision of the NER; or modifies or varies the application of a provision of the NER to that person or that class of person. Refer to section 91(5) of the NEL.

⁷ ActewAGL applied to the Australian Competition Tribunal (Tribunal) for merits review of the 2014-19 distribution determinations under s.71B of the NEL. On 26 February 2016, the Tribunal set aside the determination and remitted them to the AER. The AER subsequently sought judicial review in the Full Federal Court of the Tribunal's decision. At the time of this Draft Determination's publication, the Full Federal Court has yet to decide on the matter.

⁸ www.aemc.gov.au/Rule-changes/Participant-derogation-NSW-DNSPs-Revenue-Smoothing

⁹ The AER's duty to make distribution determinations is set out in clause 6.2.4 of the NER.

¹⁰ Refer to section 71A of the NEL.

¹¹ Section 71A of the NEL provides the definition of 'affected or interested person or body' for the purposes of a reviewable regulatory decision. The definition includes: the network service provider to which the decision applies; a network service provider, network service user, prospective network service user or end user whose commercial interest are materially affected by the decision; a user or consumer association; and a reviewable regulatory decision process participant (e.g. stakeholders who have provided submission to the determination process).

determination can apply to the Australian Competition Tribunal (Tribunal) for a review of the decision under the limited merits review framework in Division 3A of the NEL. In general terms, the applicant must demonstrate an error of fact, incorrect exercise of discretion, or unreasonableness by the AER in respect of the distribution determination.¹² In addition, the applicant must demonstrate why the Tribunal varying or setting aside that decision on the basis of one or more of those grounds would, or is likely to, result in a decision that is materially preferable to the existing decision in terms of making a contribution to the achievement of the national electricity objective (NEO). If the affected party or the AER is not satisfied with the decision of the Tribunal, it may apply to the Federal Court of Australia for judicial review of the Tribunal's decision.

1.2.2 Distribution determinations and undertakings relevant to this rule change request

Status of determinations and reviews

The final distribution determination relevant to the rule change request was made by the AER in April 2015. This distribution determination is referred to as the 2015 distribution determination by ActewAGL in its rule change request and it covers the period from July 2015 to June 2019.¹³

ActewAGL applied for merits review of the AER's final determinations in May 2015. The Tribunal made its decision on 26 February 2016 to set aside the AER's decisions.¹⁴ The decision required the AER to remake its final determination in accordance with the Tribunal's directions. Subsequent to the Tribunal's decision, the AER has applied to the Federal Court for judicial review of the Tribunal's decision. The judicial review proceedings are still ongoing.

Undertakings provided to the AER by ActewAGL

On 16 May 2016, ActewAGL gave an undertaking¹⁵ to the AER under section 59A of the NEL that sets out how network prices will be determined in 2016/17. The

¹² The grounds for review available under the limited merits review framework are: (a) the AER made an error (or more than one error) of fact in its findings and that error of fact (or, if more than one error, those errors in combination) was material to the making of the decision; (b) the exercise of the AER's discretion was incorrect, having regard to all the circumstances; (c) the AER's decision was unreasonable, having regard to all the circumstances. Refer to s. 71C of the NEL.

¹³ There are two distribution determinations covering the 2014-19 period. The first covers the 'transitional regulatory control period' of 2014-15 and the second covers the 'subsequent regulatory control period' of 2015-19. The requirement to have two distribution determinations for the 2014-19 period is set out in Part ZW, Division 2 of Chapter 11. This is to allow the AER and DNSPs to transition to changes made to Chapter 6 of the NEL under the Commission's 2012 rule change on the economic regulation of network service providers. The 2015 distribution determinations as referred to by the proponents are the distribution determinations covering the 2015-19 period. Refer to s. 71A of the NEL.

¹⁴ The application for review made by the NSW DNSPs and ActewAGL were heard together by the Tribunal.

¹⁵ The ActewAGL undertaking provides for the 2016/17 network use of system (NUOS) charges to be set as 2015/16 approved prices adjusted to include changes in consumer price index in 2015/16.

undertaking means that the revenue recovered by the proponent during 2016/17 is likely to be different from the amount it is entitled to recover once the outcomes of the judicial review proceedings are known, and the processes of finalising the distribution determination is completed (if the AER remakes the final determination). The Commission understands that ActewAGL is expected to provide an undertaking for 2017/18 network prices.

1.3 Issues the rule change request seeks to address

1.3.1 Potential for significant price volatility in the absence of a rule change

ActewAGL submits that when the judicial review proceedings conclude, similarly to NSW DNSP customers¹⁶, ActewAGL's customers may experience a price shock in the final year of the current regulatory control period¹⁷ in the absence of a rule change.

The reasons for this potential price shock are explained below. In summary, ActewAGL considers that under current NER provisions, it is likely that the outcome of the judicial review proceedings will result in customers facing either one of the following:

- large price increase in 2018/19, followed by a large price decrease in 2019/20; or
- large price decrease in 2018/19, followed by a large price increase in 2019/20.

ActewAGL considers that either of these outcomes is not in the long term interests of consumers. ActewAGL considers that it is preferable to instead smooth out any price increase or decrease over a longer period.

The rule change request further explains this issue under the two possible outcomes of the judicial review proceedings:

- **The AER is required to remake the 2015 determination.**¹⁸ Under the current rules, any adjustment to total revenue requirements as a result of the AER's remaking of the 2015 distribution determination must be recovered within the regulatory control period.¹⁹ As it is unlikely that the remade 2015 distribution determinations will be in place until the fifth year of the current regulatory control period,²⁰ any adjustment to total revenue requirements would need to be fully recovered in the 2018/19 regulatory year. This is likely to lead to significant network price volatility. ActewAGL submits that in the absence of a rule change, it is unclear whether the significant price volatility that results from the change in

¹⁶ ActewAGL has referenced the NSW DNSP rule change request for this part of the rule change request – refer to ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, Attachment 1, pars 3-5.

¹⁷ The rule change request defines the current regulatory control period as the period between 1 July 2014 to 30 June 2019.

¹⁸ This situation could arise as a consequence of Tribunal's decisions. Refer to ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, Attachment 1, p. 5.

¹⁹ ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, Attachment 1, p. 2.

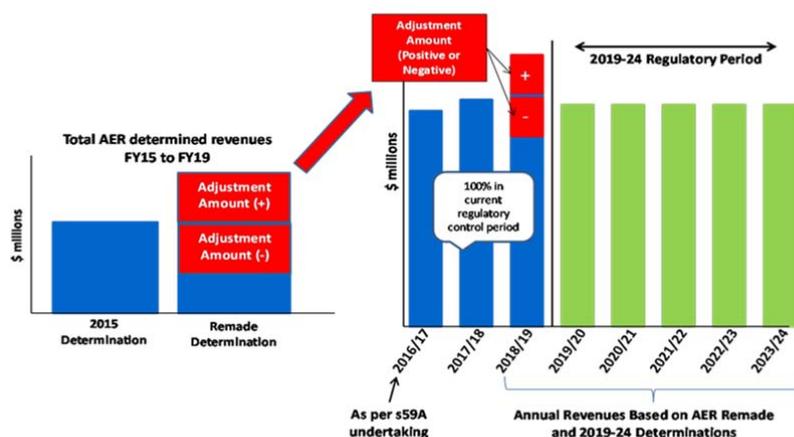
²⁰ The fifth year is the final year of the 2014-19 regulatory control period.

the revenue requirement can be managed by spreading the revenue impact over a longer period.²¹

- **The AER is not required to remake the 2015 distribution determinations.**²² The rule change request states that price volatility may occur even if the AER is not required to remake the 2015 determination, for example, if the AER is successful on all grounds in the judicial review. The price volatility results from a combination of the undertakings for 2015/16 and the average revenue cap form of regulation. The allowed revenue for the fifth year of the current regulatory control period will need to be reduced or increased to meet the revenue requirement allowed by the AER in the 2015 distribution determination. This creates the potential for volatile network prices.

Figure 1.1 illustrates the potential for a price shock in the absence of a rule change. This figure indicates the potential revenue change that would have a direct flow on effect to 2018/19 prices.

Figure 1.1 Potential for price shock without a rule change



Source: Ausgrid, Endeavour Energy and Essential Energy, *Request for a rule change relating to derogation for the current regulatory control period and subsequent regulatory control period to minimize pricing volatility following the Australian Competition Tribunal's decision*, p.5

²¹ ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, Attachment 1, p. 2.

²² This situation could arise if the Full Federal Court finds in favour of the AER in its judicial review application. Refer to ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, Attachment 1, p.17.

1.3.2 NER does not address the issue

The rule change request states that the NER does not contemplate the implications of extended judicial review proceedings on the recovery of revenue within and between regulatory control periods.²³ Two clauses were identified as limiting the proponent's ability to reduce price volatility by allowing adjustments to revenue to be recovered over two regulatory control periods. These clauses are:

- **Clause 6.5.9 - The X factor.** The X factor is set by the AER for each regulatory year to determine a smooth price path over a regulatory control period. Clause 6.5.9 requires X factors to be set so that the total revenue requirement for a distribution network service provider for a regulatory control period is recovered within that regulatory control period. ActewAGL contends that allowable revenue in the remade AER determination may be significantly different from the allowable revenue in the 2015 determination and prices set under the ActewAGL undertaking. In this case, and in the absence of a participant derogation, ActewAGL considers that AER would be required to provide that ActewAGL recover or return the full impact of the adjustment in year 5 of the current regulatory control period.²⁴
- **Clause 6.4.3 - Building block approach.** This clause allows revenue increments and decrements from the previous regulatory control period to be included in the revenue building blocks of a subsequent determination. ActewAGL contends that such inclusion is limited to amounts arising from the operation of a control mechanism, but that there would be no revenue increments or decrements arising from the application of ActewAGL's control mechanism.²⁵

1.4 Solution proposed in the rule change request

As have the NSW DNSPs, ActewAGL has sought to resolve the issues discussed above by proposing a rule that allows it to recover any increase in its annual revenue requirements for the current regulatory control period over two regulatory control periods.²⁶

The proponent considers that the proposed rule would:

- allow the proponent to recover the revenue that it is entitled to recover, by providing a reasonable opportunity to recover at least its efficient costs (as determined by the AER)
- avoid price shocks for consumers

²³ ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, pars 24-32 &45-51.

²⁴ ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, pars 27 & 47.

²⁵ ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, par 48.

²⁶ ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, pars 61-95.

- increase regulatory certainty
- enable efficient investment in, and efficient use of, electricity services.

The proponent outlined the following process for revenue recovery in the rule change request, under the assumption that the AER will remake the distribution determination for the current regulatory control period as a result of the judicial review proceedings before 1 March 2018:²⁷

- Step 1 – AER determines the adjustment amount and the allocation between regulatory control periods:
 - determine the “adjustment amount” in respect of distribution standard control services, annual metering services and transmission standard control services for the current regulatory control period, which is the change in the sum of the annual revenue requirements approved by the AER in the remade 2015 determinations compared to the sum of the annual revenue requirements approved by the AER in the 2015 determination for the current regulatory control period
 - determine the “subsequent adjustment amount” in respect of distribution standard control services, annual metering services and transmission standard control services for the subsequent regulatory control period
 - determine the “annual adjustment amount” for each remaining year of the current regulatory control period
 - determine the aggregate change in STPIS award or penalty under the remade 2015 determination compared to the STPIS award or penalty under the 2015 determination/ ActewAGL undertaking (S_t adjustment amount)
 - determine the annual S_t adjustment amount for each remaining year of the current regulatory control period.
- Step 2 – AER and ActewAGL adjust revenues for the current regulatory control period through the pricing proposal process:
 - ActewAGL may propose to revise, or the AER may revise, the annual adjustment amounts through varying the average revenue cap, which would be adjusted under the derogation for distribution revenue and STPIS adjustments.
- Step 3 – AER includes the subsequent adjustment amount in the subsequent determination:
 - AER includes the subsequent adjustment amount as a building block for the first regulatory year of the subsequent regulatory control period.

The proponent considered that the outlined process would still apply if the AER ceased to be under an obligation to remake the 2015 determination. In this case, adjustment amounts under the outlined process would be zero. However, ActewAGL could

²⁷ ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, pars 61-88.

propose to revise, or the AER could revise, the annual adjustment amounts for a regulatory year in the pricing proposal to minimise price volatility.²⁸

The proponent considered that the outlined process would still apply if the AER were to remake the distribution determination for the current regulatory control period as a result of the judicial review on or after 1 March 2018.²⁹ In this case, the proponent considered that:

- adjustment amounts would also cover transmission standard control services and annual metering services
- the AER could include the full adjustment amount as a building block for the first regulatory year of the subsequent regulatory control period.

The proponent considered that the proposed participant derogation would have limited administrative costs.³⁰

1.5 The rule making process

On 17 November 2016, the Commission published a notice advising of its commencement of the rule making process and consultation in respect of the rule change request.³¹ The Commission also published a consultation paper that identified specific issues for consultation. Submissions closed on 15 December 2016. On 7 February 2017, the Commission extended the deadline for the draft determination to 27 April 2017.

The Commission received seven submissions as part of the first round of consultation. The Commission has considered all issues that have been raised by stakeholders in submissions, and key issues are discussed throughout the draft determination. Appendix A sets out a summary of all the other issues that the submissions have raised, in addition to the Commission's response to each issue.

28 ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, pars 86-88.

29 ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, pars 89-95.

30 ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, pars 99-101.

31 This notice was published under section 95 of the NEL.

1.6 Consultation on draft rule determination

The Commission invites submissions on this draft rule determination by 20 June 2017.

Any person or body may request that the Commission hold a hearing in relation to the draft rule determination. Any request for a hearing must be made in writing, and must be received by the Commission no later than 3 May 2017.

Submissions and requests for a hearing should quote project number ERC0216, and may be lodged online at www.aemc.gov.au or by mail to:

Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

2 Draft rule determination

2.1 The Commission's draft rule determination

The Commission's draft rule determination is to make a more preferable draft rule, under which:

- the AER may determine that the revenue ActewAGL is entitled to recover in the current regulatory control period as a result of the judicial review proceedings, be recovered over the current regulatory control period and the subsequent regulatory control period in a way that minimises price volatility for consumers³²
- the AER may determine that the revenue ActewAGL is entitled to recover for the current regulatory control period as a result of the judicial review proceedings (but which it has not been able to recover during that period), be included in the revenue allowance of ActewAGL for the subsequent regulatory control period.³³

The Commission's reasons for making this draft determination are set out in Chapter 3.

This chapter outlines:

- the rule making test for changes to the NER and Commission's consideration of the draft rule against the national electricity objective (NEO)
- the assessment framework for considering the rule change request
- the Commission's consideration of the draft rule against its strategic priorities.

2.2 Rule making test

2.2.1 Achieving the national electricity objective (NEO)

Under the NEL, the Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the NEO.³⁴ This is the decision making framework that the Commission must apply.

The NEO 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.”³⁵

³² Sections 4.1.2 and 4.2.2 of this draft determination provides further details on the circumstances under which the AER may determine the allocation of revenue across the two regulatory control periods.

³³ Sections 4.2.2, 4.4 and 4.5 provides further details on the circumstance in which a revenue increment or decrement is made in respect of the subsequent regulatory control period.

³⁴ Refer to section 88 of the NEL.

³⁵ Refer to section 7 of the NEL.

The Commission considers that the most relevant aspects of the NEO are the efficient operation and use of electricity services with respect to the price of electricity.

2.2.2 Revenue and pricing principles

In addition to having regard to the NEO, the Commission must take into account the revenue and pricing principles in making a rule with respect to (amongst other things) the regulation of revenue earned, or that may be earned, by DNSPs from provision of services that are the subject of a distribution determination.³⁶

2.3 Assessment framework

In assessing the rule change request against the NEO, the Commission has considered the following criteria:

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

A significant revenue adjustment could result from the outcome of the judicial review proceedings. This may lead to consumers experiencing a large network price increase or decrease between 2018/19 and 2019/20.³⁷ This price volatility may lead some consumers to make inefficient budgetary decisions on energy spending, or inefficient investment decisions on the use of electricity services. The Commission has considered whether minimising price volatility would be in the long term interests of consumers in this case.

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

If minimising price volatility is in the long term interests of consumers, the Commission has assessed the best method to achieve minimisation of price volatility.

- **Is enabling the proponents to recover the revenue that they are entitled to aligned with the revenue and pricing principles?**

The Commission has considered whether the draft rule is consistent with the following revenue and pricing principles:³⁸

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

³⁶ Refer to section 88B and Items 25-26J of Schedule 1 of the NEL. The revenue and pricing principles are set out in section 7A of the NEL.

³⁷ 2018/19 is the final year in the current regulatory period and 2019/20 is the first year of the next regulatory period.

³⁸ Refer to section 7A of the NEL.

2.4 Summary of reasons for making a more preferable rule

2.4.1 Key features of the draft rule

Having considered the rule change request against the assessment framework set out in section 2.3, the Commission has decided to make a draft rule. The draft rule is published with this draft determination. The key features of the draft rule are:

- The draft rule allows the proponents to recover any increased or decreased revenue as a result of the outcome of the judicial review proceedings over the current regulatory control period and/or subsequent regulatory control period. The draft rule is designed to allow each proponent to recover only the revenue that it is entitled to recover, and not derive any windfall gains or losses as a result of the application of the draft rule.
- The draft rule provides the AER with the discretion to determine whether any revenue adjustments should be made in order to smooth revenue across the current regulatory control period and the subsequent regulatory control period,³⁹ including the allocation of amounts between the two periods.
- The AER determination under the draft rule will be finalised and issued separately. The AER determination will be given effect through the pricing proposal and distribution determination processes. The AER determination will not affect the remaking of the 2015 distribution determination (if remaking is required), or the terms of the 2015 distribution determination (if it is affirmed or varied by the Tribunal), or the terms of the 2020 determination (other than to include the variation amount).

The Commission is satisfied that the draft rule will, or is likely to, contribute to the achievement of the NEO.

2.4.2 How the draft rule compares with the proposed rule

Under section 91A of the NEL, the Commission may make a rule that is different (including materially different) from a proposed rule if it is satisfied that, having regard to the issues raised by the rule change request, the more preferable rule will, or is likely to, better contribute to the achievement of the NEO than the proposed rule.

The Commission is satisfied that the draft rule, which is a more preferable rule, will, or is likely to, better contribute to the achievement of the NEO for the following reasons:

- The draft rule incorporates elements of ActewAGL's proposed rule and is designed to achieve the same outcome of minimising price volatility for consumers. The main difference between the proposed rule and the draft rule is that the draft rule gives the AER greater discretion to decide whether smoothing should occur between the current regulatory control period and the subsequent regulatory control period. If the AER decides to smooth revenue across periods, the draft rule provides the AER discretion as to how to make any necessary revenue adjustments. The draft rule also sets out a process to be followed if the

³⁹ This is applicable where the timing of the judicial review outcome provides the opportunity for revenue adjustment to be smoothed across two regulatory control periods.

AER is required to reopen the subsequent distribution determination to incorporate adjustment to revenue for that period.⁴⁰

- The draft rule also more clearly distinguishes between the different processes that need to apply depending on when the final outcome of the judicial review proceedings is known.

2.4.3 Key reasons for this decision

This section outlines the reasons for the Commission's decision.

Reducing price volatility

The Commission considers that the smoothing of any increase or decrease in revenue across two regulatory control periods will minimise price volatility. The Commission also considers that the minimisation of price volatility is in the long term interest of consumers.

In the absence of a rule change, prices could:

- rise significantly in the final year of the current regulatory control period followed by a sharp decrease in the first year of the subsequent regulatory control period; or
- fall significantly in the final year of the current regulatory control period followed by a sharp increase in the first year of the subsequent regulatory control period.⁴¹

Under these circumstances, consumers may incorrectly make the assumption that the price increase/decrease in the final year of the current regulatory control period will continue and act accordingly. The assumption may lead consumers to inefficient long term outcomes:

- consumers may spend more or less money on electricity with inefficient long term budgetary outcomes; and/or
- make/refrain from making investments in alternative energy sources or technologies based on a temporary price rise/drop.

The Commission considers that stable prices allow consumers to make informed decisions as to their energy spending and usage. If revenue recovery occurs over a longer period and the adjustment amount is smoothed over two regulatory control periods, prices would be more stable. The Commission considers that, in this case, the benefits of smoothing revenue across two regulatory control periods outweigh any costs of revenue recovery over a longer period.

Method of minimisation

The Commission considers that the draft more preferable rule is better able to minimise price volatility than the proposed rule for the following reasons:

⁴⁰ This is the distribution determination of the subsequent regulatory control period.

⁴¹ Price trajectory would depend on the outcome of the judicial review proceedings in relation to the distribution determination for the current regulatory control period, and the distribution determination for the subsequent regulatory control period.

- The proponent set out a detailed revenue smoothing mechanism in its rule change request. However, as the outcome of the judicial review proceedings is uncertain, a variety of potential scenarios could eventuate. Therefore, the Commission considers that the use of a prescriptive mechanism, as outlined in the proposed rule, is unlikely to provide sufficient flexibility to provide an efficient outcome for consumers.
- The Commission considers that the AER, in consultation with the proponent and other relevant stakeholders, is in the best position to make informed decisions as to whether and how to smooth revenue across periods to minimise price volatility. The draft rule provides the AER with the discretion to make these decisions in accordance with the requirements of the draft rule:
 - The AER must set out in its determination on revenue smoothing the amount that is to be carried over across two regulatory control periods, where relevant.
 - The impact of the AER's determination under the draft rule must be neutral in terms of net present value.
 - The AER may only decide to smooth revenue across two regulatory control periods if it is satisfied that doing so is reasonably likely to minimise the variance in Network Use of System charges between regulatory years and regulatory control periods.
 - The AER must consult with ActewAGL and any stakeholders that it considers appropriate, as part of its decision making process.

Alignment with revenue and pricing principles

The Commission considers that the draft rule is compatible with the application of the following relevant revenue and pricing principles:

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

The Commission considers that allowing the AER discretion to determine any revenue adjustment across two regulatory control periods in accordance with the requirements set out in the draft rule would:

- provide the proponents with a reasonable opportunity to recover their efficient costs, as well as
- achieve the most efficient outcomes for consumers.

2.5 Consistency with strategic priority

This rule change request is relevant to the Commission's strategic priority relating to market and network arrangements that encourage efficient investment and flexibility. The draft more preferable rule would allow the proponent to recover its efficient costs, which consequently encourages efficient investment. In addition, allowing revenue to be recovered over two regulatory control periods will mitigate against price volatility for consumers. The draft more preferable rule would also provide an appropriate level of flexibility to adapt to changing circumstances.

3 Reasons for making more preferable rule

This chapter outlines the rationale for the Commission's draft more preferable rule to allow the proponent to recover adjusted revenue across the current regulatory control period and the subsequent regulatory control period. The chapter is structured to discuss the Commission's reasoning on the following key issues:

- reducing price volatility
- method of minimisation of price volatility
- alignment with revenue and pricing principles

3.1 Reducing price volatility

3.1.2 Proponent's views

As discussed in section 1.3, the proponent submits that the outcome of the judicial review proceedings could lead to significant adjustment to the revenue that it is entitled to recover in the current regulatory control period. The proponent also submits that under the current rules, any revenue adjustment can only be recovered in the current regulatory control period. In the absence of a rule change, ActewAGL customers could experience a significant price shock. This could occur regardless of whether or not the AER is required to remake the 2015 determination.

The proponent has sought to resolve this issue by proposing a mechanism that allows the recovery of revenue across the current regulatory control period and the subsequent regulatory control period. The proposed mechanism is described in section 1.4.

The proponent considers that the proposed rule promotes the NEO and is consistent with the revenue and pricing principles as it:

- allows the proponent to recover the revenue that it is entitled to, thus providing a reasonable opportunity to recover at least its efficient costs (as determined by the AER)
- avoids price shocks for consumers
- increases regulatory certainty
- enables efficient investment in, and efficient use of, electricity services.

The proponent also agrees with the analysis of NSW DNSPs on the impact of setting revenues above or below efficient costs.⁴² Boxes 3.1 and 3.2 set out these considerations. NSW DNSPs submitted that their proposed rule achieves a balance between the objectives of minimising pricing volatility and the setting of efficient prices to encourage efficient spending and usage.⁴³

⁴² ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, Attachment 1.

⁴³ ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, Attachment 1, p. 29.

Box 3.1. Impacts of revenue set above efficient level

The proponents consider that the main impacts arising from revenues that are set above efficient levels for a short period include lower usage and network under-utilisation.

This could lead to:

- increased uptake by consumers of other energy sources, such as gas or renewable energy, based on comparisons of network charges that are above efficient levels in the short term
- purchase of equipment by consumers, such as battery storage / load control, based on inefficient short term pricing arrangements that could lead to consumers not receiving the expected payback on their investment
- future network price increases to meet the requirements of the AER's revenue cap form of price control if the networks are under-utilised.

Source: ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, Attachment 1pp. 28-29

Box 3.2 Impacts of revenue set below efficient level

The proponents consider that the main impacts arising from revenues that are set below efficient levels for a short period include higher usage and network over-utilisation.

This could lead to:

- reduced uptake by consumers of other energy sources that may be efficient in the long term, based on inefficient short term price comparisons
- lack of investment by consumers in equipment, such as battery storage/load control, that could otherwise lead to efficient avoidance of future network charges
- increased capital investment to meet increased demand growth and corresponding future network price increases for customers.

Source: ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, Attachment 1pp. 28-29

3.1.3 Stakeholders' views

Ausgrid and Energy Networks Australia supported the rule change request. Energy Networks Australia considered that the rule change would increase regulatory certainty and promote efficient investment decisions by decreasing price volatility.⁴⁴ Ausgrid considered that minimising price volatility between regulatory years and regulatory control periods aligns with the intent of the regulatory framework.⁴⁵

Red and Lumo Energy agreed with the importance of reducing price volatility, but considered that the Commission should wait for the judicial review outcome before making a rule change.⁴⁶

Energy Consumers Australia agreed with the proponent's intent to reduce price volatility, and considered that electricity consumers look for predictability in order to manage their budgets. Energy Consumers Australia also stated that price volatility would cause consumers to further lose confidence in the electricity market.⁴⁷

The Ethnic Communities Council of NSW (ECCNSW) commented that it is not clear what the result of significant price volatility would be on consumer behaviour. ECCNSW also noted the lack of significant research⁴⁸ to establish what consumer attitudes and behaviour might be around rapid and significant price variation.⁴⁹

The AER recognised the potential for price shocks if a rule was not made. The AER also agreed with the proponent that price shocks would lead consumers to make inefficient decisions. The AER further elaborated that the minimisation of price shocks was a key driver of the regulatory framework, as evident in:⁵⁰

- requirement for tariffs to move towards efficient structures
- application of side constraints
- revenue smoothing through the X factor.

⁴⁴ Energy Networks Australia, *Response to Consultation Paper – NSW and ACT DNSPs revenue smoothing*, 15 December 2016.

⁴⁵ Ausgrid, *Re:ERC0210 – Participant derogation – NSW DNSPs revenue smoothing*, 12 December 2016, p.1.

⁴⁶ Red and Lumo Energy, *Re: National Electricity Amendment (Participant derogation - NSW DNSPs revenue smoothing) Rule 2016 (ERC0201)*, 15 December 2016.

⁴⁷ Energy Consumers Australia, *Submission to NSW and ACT Distribution Network Service Providers' (DNSP) revenue smoothing participant derogations (ERC0210)*, 23 December 2016.

⁴⁸ Ethnic Communities' Council of NSW clarified this statement with Commission staff during informal consultation after submission to the consultation paper closed. This statement is intended to say that no such research has been conducted by industry participants.

⁴⁹ Ethnic Communities' Council of NSW, *Submission on The National Electricity Amendment (Participant derogation - NSW DNSPs Revenue Smoothing) Rule 2016*, 15 December 2016, p. 4.

⁵⁰ AER, *NSW and ACT revenue smoothing rule change: AER submission to Australian Energy Market Commission consultation paper*, December 2016, p.16.

3.1.4 Analysis and conclusions

The Commission's research suggests that consumer preferences generally display a present bias.⁵¹ Consumers place more weight on costs and benefits in the present than on costs and benefits at any point in the future. If a significant fall in prices were to occur, consumers would prefer to experience this benefit immediately. However, given the nature of a regulatory control period, this benefit is likely to be a one-off occurrence. This may ultimately result in a significant price rise the following year, which consumers would prefer not to experience.

This research has also suggested that consumers' preferences are often time inconsistent. Consumers' interest in energy is sporadic and typically triggered by certain events, for example a sudden price shock. This supports the view that distorted price signals through price shocks could result in inefficient outcomes for consumers.

Taking into account research undertaken by the Commission and stakeholders' comments, the Commission has concluded that a mechanism that reduces price volatility by smoothing the recovery of adjustment revenue across two regulatory control periods is less likely to result in inefficient outcomes for customers. The Commission therefore considers such a mechanism to be in the long term interests of consumers.

3.2 Method of minimisation of price volatility

3.2.1 Proponent's views

The rule change request proposed a detailed mechanism that allows the recovery of revenue across the current regulatory control period and the subsequent regulatory control period. The proposed mechanism is summarised in section 1.4.

3.2.2 Stakeholders' views

The AER provided a detailed submission on the operation of the proponents' suggested smoothing mechanism. The AER outlined a set of considerations for the draft rule:⁵²

- **Allowing the proponent or the AER to vary the revenue smoothing through the pricing proposals would increase uncertainty.** The NER requires the AER to approve and publish a pricing proposal within 30 business days of receipt. The AER considers that this timeframe would not allow for stakeholder consultation on departures from the default allocation in the AER determination on adjustment amount allocation under the participant derogation. This timeframe also does not allow the AER to assess and make a decision on such a departure from the default allocation.
- **Proposed derogation creates unnecessary duplication of the regulatory process.** The proposed rule splits the decision making process on the smoothing of revenue across two separate processes: determination of revenue adjustment and

⁵¹ Oxera, *Behavioural insights into Australian retail energy markets, report prepared for the AEMC*, March 2016.

⁵² AER, *NSW and ACT revenue smoothing rule change: AER submission to Australian Energy Market Commission consultation paper*, December 2016, pp. 4-5.

allocation across regulatory control periods. This would increase the administrative burden for the AER and the proponents. The AER considers that it is preferable to finalise the allocation of revenue adjustments across regulatory control periods within the AER determination on revenue smoothing.

- **Allocation of the revenue adjustment having regard to high level principles rather than a prescribed calculation.** The AER considers that it may or may not need to remake the 2015 determinations. Moreover, the proponents may be under recovering or over recovering revenues in the current regulatory control period.

3.2.3 Analysis and conclusions

The Commission agrees with each of the AER's comments above.

The Commission considers that the smoothing mechanism in the rule change request is too prescriptive. While the mechanism does provide certainty, it is not sufficiently flexible to respond to a range of possible outcomes from the judicial review proceedings. The Commission reached this conclusion after conducting extensive consultation with ActewAGL, NSW DNSPs and the AER after submissions closed on the consultation paper. The additional consultation provided the Commission with a better understanding of the objectives that ActewAGL and NSW DNSPs are trying to achieve, and the AER's concerns regarding the proposed mechanism.

The Commission's draft more preferable rule is better able to resolve the proponent's aim of minimising price volatility by balancing the need to provide regulatory certainty, with the flexibility to respond to uncertain outcomes from the judicial review proceedings.

The draft rule takes into account the impact of the timing of the judicial review outcome on the pricing proposal and distribution determination processes. The draft rule also provides the AER with discretion to determine whether smoothing should occur between the current regulatory control period and the subsequent regulatory control period. Where the AER decides to smooth across the two periods, the draft rule also provides the AER the discretion to determine the amount allocated to the respective periods.

Importantly, the draft rule does not change the NER's application to the remaking of the 2015 determination (if the AER is required to remake it). Figure 3.4 below illustrates the framework within which the decision will operate.

A detailed explanation of the draft rule's operation can be found in chapter 4.

Figure 3.4 Analysis and conclusions: Participant derogation

Undertakings (assumed)	Revenue Determination for current regulatory control period	Revenue Determination for subsequent regulatory control period	Participant Derogation
<ul style="list-style-type: none"> AER and NSP agreements on revenue allowances for years in the current control regulatory period 	<ul style="list-style-type: none"> Revenue determination for NSPs resulting from judicial review 	<ul style="list-style-type: none"> Revenue determination for NSPs as part of regulatory proposal and determination for subsequent regulatory control period 	<ul style="list-style-type: none"> Rule change that will allow revenue smoothing across two regulatory control periods
Pricing Proposals			Scope of Rule Change

3.3 Alignment with revenue and pricing principles

3.3.1 Revenue and pricing principles

As discussed in the consultation paper, the Commission is required to consider whether the proposed rule is consistent with the revenue and pricing principles set out in section 7A of the NEL. The following revenue and pricing principles are most relevant in the context of this rule change request:

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

3.3.2 Proponent's views

The proponent agrees with NSW DNSPs that the proposed participant derogation is consistent with the revenue and pricing principles, as it:⁵³

- minimises price volatility for consumers, in the case where price volatility is not be a result of cost volatility
- provides ActewAGL with a reasonable opportunity to recover at least its efficient costs of providing the direct control services, as determined by the AER
- enhances certainty of revenue and price outcomes, which results in more efficient investment and consumption decisions
- minimises administrative costs for the AER and ActewAGL.

⁵³ ActewAGL, *Request for participant derogation to minimize pricing volatility following Tribunal determination*, Attachment 1, p.2 and pp.26-30.

3.3.3 Stakeholder views

Red and Lumo Energy considered that the rule change could breach the first and third revenue and pricing principles referred to in section 3.3.1 above.⁵⁴ They consider that a one-off full adjustment to network charges would be more consistent with these principles. Red and Lumo Energy considered that a one-off adjustment would:

- allow the proponents to recover their efficient costs immediately, if the outcome of the judicial review proceedings leads to an increase in revenue requirement; or conversely
- allow network charges to readjust to their efficient levels, if the outcome of the judicial review leads to a decrease in revenue requirements.

Public Interest Advocacy Centre considered that the Commission should:⁵⁵

- consider the adequacy of the suite of existing side constraints
- assess whether the main effect of the derogation would be to increase potential network revenues from a positive adjustment amount
- undertake further consideration of the interaction between the network pricing objective and the pricing principles
- consider adopting temporary rules that prescribe variances to the method for revenue smoothing normally adopted by the AER.

3.3.4 Analysis and conclusions

The Commission considers that the draft more preferable rule is consistent with the revenue and pricing principles discussed in section 3.3.1. The uncertainty in the timeframe of the outcome of the judicial review proceedings means that there is a possibility that an outcome may not be known until after the current regulatory control period has passed. In the absence of a rule change, ActewAGL may be prevented from recovering the efficient costs of providing network services. The draft rule therefore provides certainty that the proponent has a reasonable opportunity to recover their efficient costs between two regulatory control periods.

As discussed in section 3.1, the draft rule balances the need for regulatory certainty with the desire to minimise price volatility between regulatory years and regulatory control periods. This promotes efficient decision making by consumers by minimising price volatility in a short period of time. Therefore, the draft rule satisfies the principle that a network service provider should promote economic efficiency with respect to direct control network services.

⁵⁴ Red and Lumo Energy, *Re: National Electricity Amendment (Participant derogation - NSW DNSPs revenue smoothing) Rule 2016 (ERC0201)*, 15 December 2016.

⁵⁵ Public Interest Advocacy Centre, *Submission in response to the AEMC consultation paper on the DNSP proposed revenue smoothing derogation*, 15 December 2016.

4 Operation of the draft rule

Whilst allowing the smoothing of revenue across two regulatory control periods is a relatively simple concept, the draft rule needs to include a level of detail as it involves processes that relate to the making (and potential remaking by the AER, or affirming or varying by the Tribunal) of distribution determinations as well as the pricing proposal processes.⁵⁶ This chapter therefore provides an explanation of the intended operation of the draft rule.

This chapter is structured as follows:

- section 4.1 provides a summary of the key aspects of the draft rule
- section 4.2 outline the key factors affecting the operation of the draft rule
- sections 4.3, 4.4 and 4.5 details the operation of the draft rule under each of the three scenarios that the Commission has considered.

4.1 Key objectives of the draft rule

The key objectives of the draft rule are:

- **Provide a mechanism to minimise price volatility.** The draft rule provides a mechanism to minimise price volatility that may occur as a result of the outcome of the judicial review proceedings. As discussed in sections 2.4.3 and 3.1.4, the Commission considers that stable prices allow consumers to make efficient decisions. The Commission also considers that allowing revenue smoothing across the current regulatory control period and subsequent regulatory control period would result in more efficient outcomes for consumers.
- **Provide ActewAGL with an opportunity to recover efficient costs.** The outcome of the judicial review proceedings may not be known until after the current regulatory control period ends. The Commission considers that the draft rule provides ActewAGL with a reasonable opportunity to recover the efficient costs of providing direct control services, over the current regulatory control period and subsequent regulatory control period. The draft rule is designed so that ActewAGL does not derive any windfall gains or losses through the smoothing of revenue across the current regulatory control period and/or the subsequent regulatory control period.

4.2 Key aspects of the draft rule

4.2.1 The draft rule does not change the application of the NER to any remaking of the 2015 determination

This draft rule does not change the application of the NER to any making of a 2015 distribution determination. If, at the conclusion of the judicial review proceedings, the AER is required to remake the 2015 distribution determination, it must do so in

⁵⁶ The key processes are ActewAGL's preparation and the AER's subsequent review and approval of annual pricing proposals under Part I of Chapter 6 of the NER.

accordance with the Tribunal's decision as well as the current NER provisions that cover the making of distribution determinations.

The draft rule is designed to work alongside the existing rules, and to provide a mechanism to allow smoothing of the recovery of revenue across two regulatory control periods to minimise price volatility if the need arises.

The draft rule also provides for certain limited circumstances in which a DNSP is not required to comply with existing rules relating to the pricing proposal process and tariff arrangements. This is only to the extent necessary to give effect to the operation of the draft rule.⁵⁷ These modifications to the existing requirements under the NER are set out in clause 8A.14.8 of the draft rule. The Commission considers such modifications to be appropriate to eliminate inconsistencies between the operation of the draft rule and the parts of Chapter 6 that continue to operate concurrently with the derogation.

4.2.2 Provides the AER with discretion

Where the timing of the outcome of the judicial review proceedings provides the opportunity to smooth the recovery of revenue across two regulatory control periods, the draft rule provides the AER discretion to:

- decide whether revenue should be smoothed across two regulatory control periods; and if the AER decides to smooth the recovery of revenue across two regulatory control periods
- decide how any adjustment is allocated between the two regulatory control periods.

Where the AER decides revenue should be smoothed across two regulatory control periods, it must be satisfied that doing so would reasonably minimise variation in network use of system charges.

4.2.3 Provides transparency of process

The draft rule requires the AER to make a separate decision in relation to revenue adjustment and smoothing, and to publish a separate determination (adjustment determination) that sets out the reasons for its decision. Before making the adjustment determination, the AER must consult with the proponent as well as the relevant stakeholders. The adjustment determination will also set out how the AER allocates revenue across the current regulatory control period and subsequent regulatory control period.⁵⁸

Once the AER has decided on the revenue adjustment required, it is given effect through the annual pricing proposal process and the revenue determination process for

⁵⁷ For example, under clause 8A.14.8(b)(5) of the draft the rule, the side constraint provisions do not apply to the extent that a proponent's tariffs vary from tariffs which would otherwise result from complying with those provisions, due to the application of the participant derogation.

⁵⁸ It is important to note that the adjustment determination also captures circumstances where adjustment is made to revenue allowances in the subsequent regulatory control period only.

the subsequent determination period.⁵⁹ The draft rule differs from the proposed rule in that the draft rule does not provide either the AER or the proponent an opportunity to propose a different adjustment amount at the pricing proposal process.

4.3 Matters affecting the operation of the draft rule

Prior to discussing the detailed operation of the draft rule, it is useful to outline the possible outcomes of the judicial review proceedings and the timing of these outcomes as they will affect the following:

- the price setting process for the final year of the current regulatory control period
- the distribution determination process for the subsequent regulatory control period.

4.3.1 Possible outcomes of the judicial review proceedings

At the conclusion of the judicial review proceedings, there are two possible outcomes:

- **The AER is required to remake the 2015 distribution determinations.** Under this outcome, the Tribunal remits the matter back to the AER. Then, the AER is required to remake the 2015 distribution determinations in accordance with the Tribunal's orders and the NER provisions that govern the making of distribution determinations in Chapter 6 of the NER.
- **The Tribunal affirms or varies the 2015 distribution determinations.**⁶⁰ Under this outcome, the Tribunal affirms⁶¹ or varies⁶² the 2015 distribution determinations, and makes no concurrent order to set aside and remit the matter back to the AER to make the decision again.⁶³

4.3.2 Timing of the outcome

The timing of the outcome of the judicial review proceedings will have a significant impact on how revenue is recovered in the current regulatory control period and the subsequent regulatory control period. The Commission has considered three broad scenarios that the draft rule would operate in. These scenarios are:

- **Scenario 1: recovery of revenue across the current regulatory control period and subsequent regulatory control period.**⁶⁴ This scenario applies prior to 1

⁵⁹ In Scenario 3 (section 4.3.2 of this Draft Determination), the adjustment determination is issued after the distribution determination of the subsequent regulatory control period but requires a re-opening of the distribution determination.

⁶⁰ Put simply, the AER is not required to remake the 2015 distribution determinations under this outcome.

⁶¹ Refer to section 71P(2)(a) of the NEL or any other relevant power of the Tribunal.

⁶² Refer to section 71P(2)(b) of the NEL or any other relevant power of the Tribunal.

⁶³ Refer to section 71P(2)(c) of the NEL or any other relevant power of the Tribunal.

⁶⁴ Clause 8A.14.4 of the draft rule covers this scenario.

December 2017 or 1 March 2018.⁶⁵ Under this scenario, the judicial review outcome is known ahead of the price setting process⁶⁶ for the 2018/19 regulatory year⁶⁷ and provides the opportunity for the revenue to be recovered over the current regulatory control period and the subsequent regulatory control period.

- **Scenario 2: recovery of revenue in the subsequent regulatory control period only and no requirement for reopening of the distribution determination for the subsequent regulatory control period.**⁶⁸ This scenario applies between 1 December 2017/1 March 2018 and 1 February 2019. Under this scenario, the judicial review outcome is known after the commencement of price setting process for the 2018/19 regulatory year but before the AER has made the distribution determination for the subsequent regulatory control period.⁶⁹ As the price setting process for the 2018/19 regulatory year have already commenced in this scenario, there is insufficient time to include an adjustment amount in the proponent's pricing proposal for that year. However, as the AER would not have finalised its decision for the subsequent regulatory control period, revenue can be included in (or removed from) the subsequent distribution determination.
- **Scenario 3: recovery of revenue in the subsequent regulatory control period only and reopening of the distribution determination for the subsequent regulatory control period.**⁷⁰ This scenario applies between 1 February 2019 and 1 December of the fourth final regulatory year of the subsequent regulatory control period.⁷¹ Under this scenario, there is insufficient time for revenue to be included in the distribution determination of the subsequent regulatory control period. A limited re-opening of the subsequent regulatory control period's distribution determination would be required to incorporate the revenue.

⁶⁵ The timeframe for the application of scenario 1 is prior to 1 December 2017 in the case that the Tribunal affirms or varies the 2015 distribution determination, and 1 March 2018 in the case that AER remakes the 2015 distribution determination.

⁶⁶ The key processes are the DNSPs' preparation and the AER's subsequent review and approval of annual pricing proposals.

⁶⁷ This is the final regulatory year of the current regulatory control period.

⁶⁸ Clause 8A.14.5 of the draft rule covers this scenario.

⁶⁹ The subsequent regulatory control period will commence on 1 July 2019. In accordance with clause 6.11.2 of the NER, the AER is required to publish ActewAGL's distribution determination by no later than 30 April 2019, which is two months before the commencement of the subsequent regulatory control period.

⁷⁰ Clause 8A.14.6 of the draft rule covers this scenario.

⁷¹ Clause 6.3.2(b) of the NER requires the length of the regulatory control period to be a minimum of five years and the AER has historically set distribution determination at this length. The Commission's intent in setting this end date is to ensure there is at least three full regulatory years for the subsequent adjustment amount to be recovered regardless of the length of the regulatory control period determined by the AER.

4.4 Operation of the draft rule under scenario 1 - recovery of revenue in both current regulatory control period and the subsequent regulatory control period

In this scenario, to reduce price volatility, the AER may decide to increase the proponent's allowed revenue in the current regulatory control period by a specified amount and decrease its allowed revenue in the subsequent regulatory control period by an equivalent amount in NPV terms, or vice versa.

4.4.1 If the AER is required to remake the 2015 distribution determination

This scenario applies prior to 1 March 2018. Under this scenario, the judicial review outcome is known ahead of the pricing proposal process for the 2018/19 regulatory year.

The making of the adjustment determination

At the time of remaking the 2015 determination for the proponent, the AER may make a separate but concurrent decision (adjustment determination) on whether to allow revenue to be recovered over the current regulatory control period and subsequent regulatory control period, and how much to recover in each period. The adjustment determination must be published at the same time that the AER publishes the remade 2015 distribution determination.

For the avoidance of doubt, the AER is required to publish an adjustment determination even if it decides not to smooth revenue across the current and subsequent regulatory control periods.

Determining the adjustment amounts

If the AER determines to allow revenue recovery across both the current regulatory control period and subsequent regulatory control period, the adjustment determination must set out how the AER determines the following:

- **Adjustment amount.** The adjustment amount is a revenue increment/decrement to the total annual revenue that may be earned by the proponent for 2018/19 in accordance with the annual revenue requirement and control mechanism that apply under the remade 2015 distribution determination. This amount represents the revenue that is re-allocated between the current regulatory control period and the subsequent regulatory control period to minimise price volatility.
- **Subsequent adjustment amount.** The subsequent adjustment amount is the inverse of the adjustment amount.⁷² This amount is to be included in the annual revenue requirement of the first regulatory year of the subsequent regulatory control period at the AER's discretion.⁷³

In determining the above amounts, the AER needs to be satisfied that their application would be reasonably likely to minimise variation in the network use of system

⁷² For example, if the adjustment amount is a revenue increase of \$1, then the subsequent adjustment amount is the NPV equivalent of a \$1 revenue decrease.

⁷³ The Commission considers that the AER has the discretion to smooth the subsequent adjustment amount over the subsequent regulatory control period through the application of the X factor.

charges⁷⁴ between the penultimate and final regulatory years of the current regulatory control period (2017/18 and 2018/19) and between the current regulatory control period and the subsequent regulatory control period.

The AER must also ensure that the adjustment amount and subsequent adjustment amount are equivalent in net present value terms. This means that the relevant proponent does not derive any windfall gains or losses as a result of revenue smoothing.

Recovery of adjustment amount in the current regulatory control period

In the current regulatory control period, the AER's adjustment decision is given effect to through the pricing proposal for 2018/19. The pricing proposal for 2018/19 must provide for the recovery of the following amount:

- total annual revenue for the final regulatory year, determined in accordance with the annual revenue requirement and control mechanism under the remade 2015 distribution determination,⁷⁵ plus or minus (as applicable)
- the adjustment amount.

Recovery of adjustment amount in the subsequent regulatory control period

As discussed above, the subsequent adjustment amount is to be included as an increment or decrement in the annual revenue requirement for the first regulatory year of the subsequent regulatory control period. This amount may be smoothed across the whole of the subsequent regulatory control period under the AER's normal process of setting smoothed revenue through the application of X factor.

The subsequent adjustment amount is able to be included in the annual revenue requirement of first regulatory year of the subsequent regulatory control period at the AER's discretion. The adjustment determination would be published well in advance of the subsequent distribution determination.

⁷⁴ The term 'network use of system charges' is not defined in the NER. However, 'use of system' is defined to include distribution use of system and transmission use of system - see Chapter 10 of the NER. Chapter 10 defines a distribution use of system service as a service provided to a Distribution Network User for use of the distribution network for the conveyance of electricity that can be reasonably allocated on a locational and/or voltage basis. The intention of this draft rule is to provide a mechanism to minimise the variation in the network component of the final consumers' prices.

⁷⁵ ActewAGL would set its prices to achieve this as their target revenue in the absence of this draft rule.

4.4.2 If the Tribunal affirms or varies the 2015 distribution determination

This scenario applies prior to 1 December 2017. Under this scenario, the judicial review outcome is known ahead of the pricing proposal process for the 2018/19 regulatory year.

The making of the adjustment determination

In the event that Tribunal affirms or varies the 2015 distribution determination, there may still be a need to consider whether adjustment needs to be made in order to minimise price volatility as the undertakings mean that the revenue collected by the relevant proponent is highly likely to be different to the amounts allowed under the affirmed or varied 2015 distribution determination. Under this scenario, the AER may make an adjustment determination setting out the same matters as above.

The adjustment determination must be published by 28 February 2018. This is to provide the relevant proponent sufficient time to incorporate the AER's decision when preparing the pricing proposal for 2018-19.

Determining the adjustment amounts

The process in determining the adjustment amount is the same as that described in section 4.3.1 above, except the amounts are derived with reference to the affirmed or varied 2015 distribution determination.

Recovery of adjustment amount in the current regulatory control period and the subsequent regulatory control period

Once the adjustment and subsequent adjustment amount has been determined, the method of recovery in both the current regulatory control period and the subsequent regulatory control period is the same as that described in section 4.3.1.

4.5 Operation of the draft rule under scenario 2 - recovery of revenue in the subsequent regulatory control period only and no reopening of the subsequent distribution determination is required

In this scenario, the AER must increase or decrease the proponent's allowed revenue in the subsequent regulatory control period by a specified amount to adjust for the difference between the revenue that it was entitled to recover under the undertaking and the revenue that it is entitled to recover under the in force revenue determination following the outcome of the judicial review proceedings.

4.5.1 If the AER is required to remake the 2015 distribution determination

This scenario applies between 1 March 2018 and 1 February 2019. Under this scenario, the judicial review outcome is known after the commencement of price setting processes for the 2018/19 regulatory year but before the AER has made the distribution determination for the subsequent regulatory control period.

The making of the adjustment determination

Similar to scenario 1, at the time of remaking the 2015 distribution determination for the proponent, the AER must make an adjustment determination that is separate to, but

made concurrently with the remade determination. The adjustment determination must be published at the same time the AER publishes the remade 2015 distribution determination.

Any changes to revenue would occur in the subsequent regulatory control period only as there is insufficient time for adjustments to be included in the 2018/19 pricing proposal.

Determining the variation amount and the subsequent adjustment amount

The adjustment determination must set out how the AER determines the following amounts:

- **Variation amount.** The variation amount is the difference between the total annual revenue requirement for 2018/19 in accordance with:
 - (a) the annual revenue requirement and control mechanism that apply under the remade 2015 distribution determination; and
 - (b) any undertaking that applies for that regulatory year.⁷⁶
- **Subsequent adjustment amount.** The subsequent adjustment amount is the equivalent in net present value⁷⁷ terms to the variation amount.

Recovery of the subsequent adjustment amount in the subsequent regulatory control period

The subsequent adjustment amount is to be included as an increment or decrement (as applicable) in the annual revenue requirement of the first regulatory year of the subsequent regulatory control period. This amount may be smoothed across the whole of the subsequent regulatory control period under the AER's normal process of setting smoothed revenue through the application of X factor.

Similar to scenario 1 above, the subsequent adjustment amount is able to be included in the annual revenue requirement for the subsequent regulatory control period as the adjustment determination would be published in advance of the subsequent distribution determination.

4.5.2 If the Tribunal affirms or varies the 2015 distribution determination

This scenario applies between 1 December 2017 and 1 February 2019. Under this scenario, the judicial review outcome is known after the commencement of price setting processes for the 2018/19 regulatory year but before the AER has made the distribution determination for the subsequent regulatory control period.

⁷⁶ The draft rule assumes that ActewAGL will enter into an enforceable undertaking under section 59A of the NEL to set prices for the final regulatory year of the current regulatory period.

⁷⁷ As discussed in section 4.3.1, the application of net present value is to ensure that ActewAGL does not derive any windfall gains or losses as part of the adjustment process.

The making of the adjustment determination

In the event that Tribunal affirms or varies the 2015 distribution determination, there is a high likelihood that the revenue the proponent is entitled to earn under the undertaking⁷⁸ is different to the amounts that are allowed under the affirmed or varied 2015 distribution determination. Under this scenario, the AER is required to make an adjustment determination setting out the variation amount and subsequent adjustment amount. The adjustment determination must be published by 31 March 2019.⁷⁹

Determining the variation amount and the subsequent adjustment amount

The process of determining the variation amount and the subsequent adjustment amount is the same as that described in section 4.4.1 above, except the amounts are calculated with reference to the affirmed or varied 2015 distribution determination.

Recovery of the subsequent adjustment amount in the subsequent regulatory control period

Once the adjustment and subsequent adjustment amount has been determined, the method of recovery in the subsequent regulatory control period is the same as that described in section 4.4.1.

4.6 Operation of the draft rule under scenario 3 - recovery of revenue in the subsequent regulatory control period only and reopening of distribution determination is required

In this scenario, the draft rule operates in the same way as in scenario 2, except that a limited reopening of the subsequent distribution determination is needed to incorporate the revenue adjustment. This is because the judicial review outcome is known too late for the AER to address it before publishing the subsequent distribution determination.

The operation of this part of the rule will not extend beyond 1 December of the fourth final regulatory year of the subsequent regulatory control period. The Commission's intent in setting this end date is to ensure there is at least three full regulatory years for the adjustment amounts to be recovered regardless of the length of the regulatory control period determined by the AER.⁸⁰

⁷⁸ The draft rule assumes that the relevant NSW DNSP will enter into an enforceable undertaking under section 59A of the NEL to set prices.

⁷⁹ The Commission considers this is the latest date for which any revenue increment or decrement resulting from the adjustment determination can be included in the distribution determination of the subsequent regulatory control period.

⁸⁰ Clause 6.3.2(b) of the NER requires the length of a regulatory period to be a minimum of five years and the AER has historically set regulatory control period at this length. However, the AER may decide to set a regulatory period for longer than five years.

4.6.1 If the AER is required to remake the 2015 distribution determination

The making of the adjustment determination

The requirement for the AER to make a separate adjustment determination in this scenario is the same as scenarios 1 and 2. The adjustment determination must be published at the same time as the remade 2015 distribution determination is published.

Determining the variation amount and the subsequent adjustment amount

The process of determining the variation amount and subsequent adjustment amount is the same as that described in section 4.4.1.

Recovery of the subsequent adjustment amount in the subsequent regulatory control period

Under this scenario, the draft rule requires the AER to:

- Revoke the subsequent distribution determination and make a substituted determination covering the remainder of the subsequent regulatory control period
- include the subsequent adjustment amount as an increment or decrement (as applicable) to one or more regulatory years for the remainder of the subsequent regulatory control period.

Where the AER decides to allocate the subsequent adjustment amount over more than one regulatory year, the aggregate of the amount allocated to each of the regulatory year must be equivalent in net present value terms to the subsequent adjustment amount.

In addition, the substituted distribution determination must only vary from the revoked distribution determination to the extent necessary to reflect the inclusion of the revenue increment or decrement referred to above. It is not the Commission's intention for the reopening of the subsequent distribution determination to include items unrelated to this rule change.

4.6.2 If the Tribunal affirms or varies the 2015 distribution determination

The making of the adjustment determination

Under this scenario, the AER must publish its adjustment determination by 28 February of the fourth last regulatory year of the subsequent regulatory control period.

Determining the variation amount and the subsequent adjustment amount

The process of determining the variation amount and subsequent adjustment amount is the same as that described in section 4.4.2 above.

Recovery of the subsequent adjustment amount in the subsequent regulatory control period

The recovery of the subsequent adjustment amount in the subsequent regulatory control period is the same as that described in section 4.5.1 above.

Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Commission	See AEMC
ECCNSW	Ethnic Communities' Council of NSW
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEO	National electricity objective
NSW DNSPs	New South Wales Distribution Network Service Providers. This includes Ausgrid, Endeavour Energy and Essential Energy.
Tribunal	The Australian Competition Tribunal

A Summary of other issues raised in submissions

This appendix sets out other issues raised in the first round of consultation on this rule change request, and the Commission's response to each issue. If an issue raised in a submission has been discussed in the main body of this document, it has not been included in this table.

Issue	Stakeholder	Commission's Response
Note that the discount rate for the NPV calculation will be the relevant weighted average cost of capital in the remade 2015 determination, noting that this will vary year-by-year because of annual updates to the cost of debt.	AER, p.17	The draft rule gives AER discretion to determine the discount rate.
Agree that it is the AER's task to ensure NPV neutrality in setting X factors within the constraints of the NER.	Ausgrid, p.2	The draft rule gives AER discretion to determine the applicable discount rate consistent with the existing provisions of Chapter 6 of the NER.
Consider that the proposal should take the form of general rule change to apply in future to all DNSPs in these circumstances.	Energy Consumers Australia, p.2	This is outside the scope of the rule change request.
Consider that a 'one-off' steep fluctuation and return in prices may not necessarily be a worse outcome than steady increases over 6-7 years, especially if mitigated for the most vulnerable consumers by 'one-off' supplementary payments.	Ethnic Communities' Council of NSW, p.2	The AEMC considers that reducing price volatility best promotes the National Electricity Objective.
Consider whether the likely effect of the proposed derogation would be to increase the amount of revenue that could be recovered in the absence of the derogation, regardless of the final adjustment amount.	Public Interest Advocacy Centre, p.3	The draft rule requires a revenue outcome that is neutral in Net Present Value terms.

Issue	Stakeholder	Commission's Response
Note that the best method to reduce volatility may be to retain the existing rules, including the remaining side constraints and the customer impact principle.	Public Interest Advocacy Centre, p.3	The draft rule is not inconsistent with existing NER rules on side constraints and pricing principles. The draft rule provides that the side constraint provision (clause 6.18.6 of the NER) does not apply to the extent that the proponents' tariffs vary from tariffs that would otherwise result from complying with the side constraints, due to the application of the participant derogation (clause 8A.15.8(b)(5) of the NER).
Note that movements in regulated revenue may not necessarily result in volatility.	Public Interest Advocacy Centre, p.5	The draft rule gives AER discretion to determine, in consultation with the relevant proponent and such other persons that the AER considers appropriate, whether or not to smooth revenue across the current regulatory control period and the subsequent regulatory control period under the requirement of minimising price volatility.
Consider that review of the interaction between the network pricing objective and the pricing principles, and the impact of under recovery of the adjustment amount on capital costs for networks, is important.	Public Interest Advocacy Centre, pp. 6-7	The draft rule is not inconsistent with existing NER rules on pricing principles, and is consistent with the network pricing objective in so far as it allows the recovery of efficient costs of providing direct control services for the current regulatory control period (refer to Chapter 4 of the Draft Determination).
Consider that temporary rules that prescribe variances to the method for revenue smoothing normally adopted by the AER should only be on grounds for reducing compensation for the time value of money, rather than being overly generous to networks by increasing total amount of revenue recovered.	Public Interest Advocacy Centre, p.7	The draft rule is consistent with the revenue and pricing principles (refer to section 3.3 of the draft determination), and requires that any revenue adjustment be equivalent in net present value terms.
Question whether derogation is required given significant uncertainty associated with the judicial review, and whether Commission should wait for the outcome before issuing a rule change determination.	Red and Lumo Energy, p.2	The draft rule reduces the regulatory uncertainty that is associated with the judicial review, and incorporates various timeframes and outcomes of the judicial review.
Consider that any revenue smoothing derogation that	Red and Lumo Energy,	The draft rule is consistent with the revenue and pricing principles

Issue	Stakeholder	Commission's Response
avoids required network price adjustments in favour of revenue smoothing may breach the revenue and pricing principles in the NEL.	p.2	(refer to section 3.3 of the draft determination).

B Legal requirements under the National Electricity Law

This appendix sets out the relevant legal requirements under the National Electricity Law (NEL) for the Commission to make this draft rule determination.

B.1 Draft rule determination

In accordance with section 99 of the NEL the Commission has made this draft rule determination in relation to the rule proposed by ActewAGL.

A copy of the more preferable draft rule is published with this draft rule determination. Its key features are described in section 2.4.

The Commission's reasons for making this draft rule determination are set out in Chapter 3.

B.2 Power to make the rule

The Commission is satisfied that the more preferable draft rule falls within the subject matter about which the Commission may make rules. The more preferable draft rule falls within section 34 of the NEL as it relates to the activities of persons participating in the national electricity market or involved in the operation of the national electricity system.⁸¹

B.3 Additional rule making test – Northern Territory

From 1 July 2016, the NER, as amended from time to time, apply in the Northern Territory, subject to derogations set out in regulations made under the Northern Territory legislation adopting the NEL.⁸² Under those regulations, only certain parts of the NER have been adopted in the Northern Territory.⁸³

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. This is because the provisions of the draft rule have no practical effect in the Northern Territory because they relate to a participant derogation for a distribution network service provider in the Australian Capital Territory, and is not relevant to participants in the Northern Territory.

⁸¹ Refer to section 34(1)(a)(iii) of the NEL.

⁸² Refer to National Electricity (Northern Territory) (National Uniform Legislation) (Modification) Regulations.

⁸³ For the version of the Electricity Rules that applies in the Northern Territory, refer to: [http://www.aemc.gov.au/Energy-Rules/National-electricity-rules/National-Electricity-Rules-\(Northern-Territory\)](http://www.aemc.gov.au/Energy-Rules/National-electricity-rules/National-Electricity-Rules-(Northern-Territory)).

B.4 Participant derogations

Under the NEL,⁸⁴ the Commission may make a rule (**participant derogation**) at the request of a person who is conferred a right, or on whom an obligation is imposed, under the Rules (including a Registered participant), that:

- (a) exempts, in a specified case or class of cases, that person or a class of person of which that person is a member, from complying with a provision, or a part of a provision, of the Rules; or
- (b) modifies or varies the application 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) to that person or class of person of which that person is a member.

The Commission must not make a participant derogation unless the derogation specifies a date on which it will expire.⁸⁵

B.5 Commission's considerations

In assessing the rule change request the Commission considered:

- its powers under the NEL to make the rule
- the rule change request
- submissions received during first round consultation
- the Commission's analysis as to the ways in which the proposed rule will or is likely to, contribute to the national electricity objective

There is no relevant Ministerial Council on Energy (MCE) statement of policy principles for this rule change request.⁸⁶

The Commission may only make a rule that has effect with respect to an adoptive jurisdiction if it is satisfied that the proposed rule is compatible with the proper performance of Australian Energy Market Operator's (AEMO's) declared network and system functions.⁸⁷ The more preferable draft rule is compatible with AEMO's declared network and system functions because it is unrelated to them and therefore does not affect the performance of those functions.

B.6 Power to make a more preferable draft rule

Under section 91A of the NEL, the Commission may make a rule that is different (including materially different) from a proposed rule if the Commission is satisfied that,

⁸⁴ Refer to section 91(5) of the NEL.

⁸⁵ Refer to section 103 of the NEL.

⁸⁶ Under section 33 of the NEL the Commission must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the Commission's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for Energy. On 1 July 2011 the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. The amalgamated council is now called the COAG Energy Council.

⁸⁷ Refer to section 91(8) of the NEL.

having regard to the issue or issues that were raised by the proposed rule (to which the more preferable rule relates), the more preferable rule will, or is likely to, better contribute to the achievement of the NEO. As discussed in Chapter 2, the Commission has determined to make a more preferable draft rule. The reasons for the Commission's decision are set out in Chapter 3.

B.7 Civil penalties

The Commission's draft more preferable rule does not amend any clauses that are currently classified as civil penalty provisions under the NER.

The Commission does not propose to recommend to the COAG Energy Council that any of the provisions of the more preferable draft rule be classified as civil penalty provisions.