Australian Energy Market Commission

RULE CHANGE

RULE DETERMINATION

National Electricity Amendment (Aligning TasNetworks' regulatory control periods) Rule 2015

Rule proponent

Tasmanian Networks Pty Ltd (TasNetworks)

9 April 2015

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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.

Summary

The Australian Energy Market Commission has made a rule that aligns the revenue determinations and start of the regulatory control periods of TasNetworks' transmission and distribution networks on 1 July 2019.

The Commission considers that aligning TasNetworks' revenue determinations will promote the national electricity objective because:

- it will improve the ability of TasNetworks to optimise expenditure across both its distribution and transmission networks when planning the networks, particularly given the characteristics of the two networks in Tasmania;
- it will improve the ability of the Australian Energy Regulator to consider trade offs between proposed expenditure on TasNetworks' transmission and distribution network when assessing the regulatory proposals of the two networks;
- it is likely to result in an ongoing reduction in regulatory burden associated with the transmission and distribution revenue determination processes for TasNetworks; and
- it is likely to reduce ongoing administrative costs for the Australian Energy Regulator and other stakeholders involved in TasNetworks' revenue determination processes;

Any administrative cost savings achieved by TasNetworks should ultimately benefit consumers.

The final rule is not drafted as a derogation from the National Electricity Rules, as proposed by TasNetworks, but otherwise is similar to the proposed rule except for some drafting amendments. It will commence immediately, on 9 April 2015.

Contents

1 TasNetworks' rule change request

1.1 The rule change request

On 22 October 2014, Tasmanian Networks Pty Ltd (TasNetworks) submitted a request to the Australian Energy Market Commission (AEMC or Commission) in relation to aligning the revenue determinations and start of the regulatory control periods of its distribution and transmission networks on 1 July 2019 (rule change request).[1]

1.2 Reasons for the rule change request

In the rule change request, TasNetworks submitted that the current arrangements in the NER will result in a determination for its transmission or distribution network every two or three years.[2] It considered this places unnecessary costs on TasNetworks and the AER and reduces the scope for efficiency improvements because the planning and operational benefits of the merged network business are undermined.[3] [4]

1.3 Solution proposed in the rule change request

TasNetworks sought to resolve the issue discussed above by proposing a rule to align the revenue determination processes and start of the regulatory control periods of its distribution and transmission networks. It proposed to achieve this by requiring the AER to set the length of the next regulatory control period for the distribution network to two years.[5] The revenue determinations and start of the regulatory control periods of TasNetworks' transmission and distribution networks would then be aligned on 1 July 2019. This is demonstrated in Figure 1.1 below.

1 Throughout this final rule determination, the rule change request is described as aligning the start of TasNetworks' transmission and distribution regulatory control periods on 1 July 2019. It should be noted that the Australian Energy Regulator (AER) sets the length of the periods under clauses 6.3.2(a)(4) and 6A.4.2(a)(7) of the National Electricity Rules (NER). This will affect when the 2019 periods end and when the following periods will begin. However, where a network service provider proposes a period of five years the AER must approve this period under clauses 6.12.3(e) and 6A.14.3(e) of the NER.

2 TasNetworks' rule change request, 22 October 2014, p2.

3 TasNetworks was created on 1 July 2014 through the merger of Aurora and Transend.

4 TasNetworks' rule change request, 22 October 2014, p2.

5 Currently the NER requires a regulatory control period to be at least five years. See NER clause 6.3.2(b).

Figure 1.1 TasNetworks' proposal

	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Current reg cycle for TasNetworks (Distribution)	Current regulatory period					Next regulatory period						
Current reg cycle for TasNetworks (Transmission)			Current - one-year	Next regulatory control period (process already commenced)				Aligned regulatory period				
TasNetworks' solution - Two year reg period for TasNetworks (Distribution)	Current regulatory period					2 year period		Aligned regulatory period				

Source: AEMC; TasNetworks' rule change request, 22 October 2014.

TasNetworks submitted that it has consulted with its stakeholders on the rule change request.[6] It stated its stakeholders were generally supportive of the rule change request and did not raise any issues with it.[7]

TasNetworks' rule change request included a proposed rule.

1.4 Commencement of rule making process

On 26 February 2015, the Commission published a notice advising of its intention to commence the rule making process and consultation in respect of the rule change request.[8] A consultation paper identifying specific issues and questions for consultation was also published with the notice. Submissions on the consultation paper and rule change request were due by 26 March 2015.

The Commission received two submissions on the rule change request as part of consultation. They are available on the AEMC website.[9]

The Commission proposed to treat the rule change request as a non-controversial rule because it did not consider that the proposed rule would be likely to have a significant effect on the national electricity market. Accordingly, the Commission proposed to expedite the rule change request subject to any written requests not to do so.[10] The closing date for receipt of written requests was 12 March 2015. None were received. Consequently, the rule change request was considered under an expedited process.

6 TasNetworks' rule change request, 22 October 2014, pp3-4.

7 ibid.

8 This notice was published under s. 95 of the National Electricity Law (NEL).

9 www.aemc.gov.au

10 This decision was made under s.96 of the NEL.

2 Final Rule Determination

The Commission's final rule determination is to make substantially the same rule as proposed by TasNetworks with drafting amendments.[11] The rule requires the AER to set the next regulatory control period for TasNetworks' distribution network to two years therefore aligning the revenue determinations and start of the regulatory control periods of TasNetworks' transmission and distribution networks on 1 July 2019.[12] The rule is attached to and published with this final rule determination.

This Chapter outlines:

- the Commission's rule making test for changes to the NER; and
- the Commission's consideration of the proposed rule against the national electricity objective (NEO).

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

2.1 Rule making test

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. 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."

For this rule change request, the Commission considers that the relevant aspects of the NEO are the efficient investment in and efficient operation of electricity services, in particular TasNetworks' transmission and distribution networks.[13]

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

12 The next regulatory control period for TasNetworks' distribution network will commence on 1 July 2017.

13 Under s. 88(2) of the NEL, for the purposes of s. 88(1) of the NEL the AEMC may give such weight to any aspect of the NEO as it considers appropriate in all the circumstances, having regard to any relevant Ministerial Council on Energy (MCE) statement of policy principles.

2.2 Summary of reasons

Having regard to the issues raised in the rule change request, the Commission is satisfied that the rule will, or is likely to, contribute to the achievement of the NEO for the following reasons:

- it will improve the ability of TasNetworks to optimise expenditure across both its distribution and transmission networks when planning the networks, particularly given the characteristics of the two networks in Tasmania. This may lead to more efficient planning of investment and operation of the networks;
- it will improve the ability of the AER to consider trade offs between proposed expenditure on TasNetworks' transmission and distribution network when assessing the regulatory proposals of the two networks;
- it is likely to result in an ongoing reduction in regulatory burden and therefore administrative costs for TasNetworks. This reduction in costs for TasNetworks should ultimately benefit consumers; and
- it is likely to result in a reduction in ongoing administrative costs for other stakeholders involved in the regulatory determination process including the AER and consumers and their representatives.[14]

There will be a short term increase in administrative costs for TasNetworks, the AER and other stakeholders in having a two year regulatory control period for TasNetworks' distribution network in 2017 in order to align the revenue determination processes of the two networks. However, this increase will be small and is not expected to outweigh the ongoing benefits of alignment.

The Commission therefore considers that the rule as made will promote the efficient investment in and efficient operation of electricity services, in particular TasNetworks' transmission and distribution networks. Further details on the Commission's reasons for forming this view are set out in Chapters 3, 4 and 5 below.

2.3 Other requirements under the NEL

In applying the rule making test,[15] the Commission has also taken into account the revenue and pricing principles. In particular, a key principle that has been taken into account is whether the proposed rule provides for effective incentives.[16] This is discussed in Chapter 4.

14 In assessing this rule change request, the Commission separated the impacts of aligning TasNetworks' regulatory control periods from the efficiency gains already achieved through the merger of Aurora and Transend to form TasNetworks.

15 Set out in s. 88 of the NEL.

16 NEL s. 7A(3) provides that a regulated network service provider should be provided with effective incentives in order to promote economic efficiency.

3 Is there a problem with lack of alignment?

3.1 TasNetworks' view

As set out in section 1.1, in its rule change request TasNetworks submitted that the current arrangements in the NER will result in a determination for its transmission or distribution network every two or three years.[17] It considered this places unnecessary costs on TasNetworks and the AER and reduces the scope for efficiency improvements because the planning and operational benefits of the merged network business are undermined.[18] [19] TasNetworks also provided a submission which reflects its rule change request.

3.2 Stakeholder views

The Energy Networks Association (ENA) supported TasNetworks' view.[20]

3.3 Analysis and conclusion

The Commission considers alignment of TasNetworks' transmission and distribution revenue determination processes will promote the NEO.

Alignment of TasNetworks' transmission and distribution revenue determinations will improve the ability of TasNetworks to optimise expenditure across both networks when planning its distribution and transmission networks. This is because a network service provider will generally undertake planning at the time of its revenue determination processes. As there are interdependencies between the transmission and distribution network, undertaking planning for both networks at the same time is likely to lead to more efficient planning of investment and operation of the two networks. This benefit is particularly relevant in Tasmania where the characteristics of the two networks are generally more similar than transmission and distribution networks in other jurisdictions in the national electricity market.

Similarly, alignment will improve the ability of the AER to consider trade offs between proposed expenditure on TasNetworks' transmission and distribution network when assessing the regulatory proposals of the two networks. This has the potential to provide for improved revenue determinations by the AER and therefore more efficient investment in, and operation of, the networks.

Alignment will also result in an ongoing reduction in regulatory burden, and therefore administrative costs for TasNetworks. For example, a key stage in the revenue determination process is the development of the network service provider's revenue

17 TasNetworks' rule change request, 22 October 2014, p2.

18 TasNetworks was created on 1 July 2014 through the merger of Aurora and Transend.

19 TasNetworks' rule change request, 22 October 2014, p2.

20 ENA submission to consultation paper, p1.

proposal.[21] As the methods and processes TasNetworks uses to develop its transmission and distribution revenue proposals are likely to be the same or similar for proposals of both networks, there will be synergies for TasNetworks in preparing both proposals at the same time. Similarly, it will allow TasNetworks to avoid duplication when developing its transmission and distribution regulatory proposals. Any cost savings made by TasNetworks as a result of undertaking both revenue determination processes at the same time should ultimately benefit consumers.

In a similar way, alignment of TasNetworks' transmission and distribution revenue determination processes is likely to result in an ongoing reduction in regulatory burden for the AER and other stakeholders involved in the revenue determination process. Given that the two networks are located in the same jurisdiction, there are likely to be synergies for the AER in assessing the transmission and distribution revenue proposals at the same time. Information such as demand projections and labour costs, for example, are likely to be common across both networks. In addition, consumer workshops could be held for both transmission and distribution revenue determinations at the same time thus avoiding duplication for these stakeholders.

Alignment of the processes is achieved by aligning the start of the regulatory control periods of the two networks. As the rules require the length of a regulatory control period to be a minimum of five years, this limits the ability of the AER to align the revenue determination processes of the two networks in a way that best promotes the NEO. The method of achieving alignment is discussed in Chapter 4.

21 Key elements of the proposal include forecasts of operating and capital expenditure and a proposed rate of return for investors.

4 Method of achieving alignment

As discussed in Chapter 3, the Commission considers that alignment of TasNetworks' transmission and distribution revenue determinations will promote the NEO. This chapter considers how alignment can best be achieved.

4.1 TasNetworks' view

As set out in section 1.3, TasNetworks proposed to align the revenue determination processes of its two networks by requiring the AER to set the length of the next regulatory control period for the distribution network to two years. The revenue determinations and start of the regulatory control periods of TasNetworks' transmission and distribution networks would then be aligned on 1 July 2019. This is demonstrated in Figure 4.1 below.

Figure 4.1 TasNetworks' proposal

	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Current reg cycle for TasNetworks (Distribution)	Current regulatory period					Next regulatory period						
Current reg cycle for TasNetworks (Transmission)			Current - one-year	Next regulatory control period (process already commenced)				Aligned regulatory period				
TasNetworks' solution - Two year reg period for TasNetworks (Distribution)	Current regulatory period					2 year period		Aligned regulatory period				

Source: AEMC; TasNetworks' rule change request, 22 October 2014.

In response to the consultation paper, TasNetworks submitted that a two year regulatory control period would have some disadvantages, namely an initial overlap in resource effort and a need to make changes to incentive scheme operation.[22] However it did not consider that these disadvantages would outweigh the benefits from alignment.[23]

In addition, TasNetworks considered that its proposed solution was the best method of achieving alignment because it would allow TasNetworks and its customers to more quickly realise the benefits from alignment compared to the alternative solutions discussed in section 4.3 below.[24]

22 TasNetworks' submission to consultation paper, p1.

23 ibid.

24 ibid. p3.

4.2 Stakeholder views

The ENA supported TasNetworks' views for broadly the same reasons.[25]

4.3 Analysis

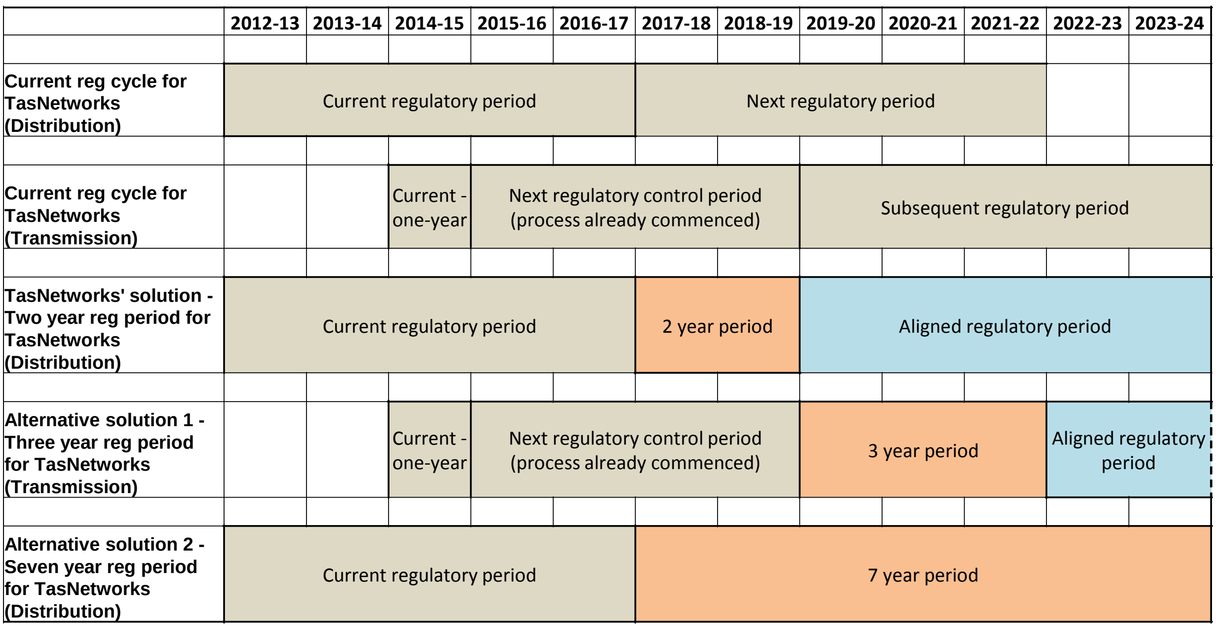
In addition to the solution proposed by TasNetworks in its rule change request, the Commission identified and considered two other ways in which the revenue determination processes of the two network businesses could be aligned:

- The first (alternative solution one) would require the AER to set a three year regulatory control period for the transmission network in 2019-20. Under this solution the regulatory control period of the transmission network aligns with that of the distribution network on 1 July 2022.

- The second (alternative solution two) would involve the AER setting the length of the next regulatory control period for TasNetworks' distribution network to seven years. Under this solution the regulatory control periods of the two networks would be aligned on 1 July 2024. A rule change would not necessarily be required for this solution as the AER can determine a regulatory control period to be seven years.[26]

The two alternative solutions in addition to the TasNetworks' solution are illustrated in Figure 4.2.

Figure 4.2 Different alignment options



Source: AEMC.

25 ENA submission to consultation paper, p1.

26 Clause 6.2(b) of the NER requires a regulatory control period to be a minimum of five years.

There are advantages and disadvantages with each of the three different options for alignment.

TasNetworks' solution

The key advantage with TasNetworks' proposed rule is that it achieves alignment the soonest. The other two options would require one more revenue determination to be undertaken before alignment would occur compared to the TasNetworks solution. This would delay the benefits of alignment.

There are two disadvantages with the TasNetworks solution. These relate to having a two year regulatory control period for TasNetworks' distribution network in 2017.

The first disadvantage is that the determination processes for TasNetworks’ 2017 and 2019 distribution determinations would run consecutively with a small amount of overlap. This means that TasNetworks, the AER and other relevant stakeholders will have limited knowledge of the outcomes of the 2017 determination process when making the 2019 determination. It will also mean a small increase in administrative burden for TasNetworks, the AER and other stakeholders during the overlap set out in Figure 4.3.

Figure 4.3 Overlap in determination processes

Steps in TasNetworks’ 2017 and 2019 determination processes	Date
DNSP notifies AER on value of dual function assets	31 Oct 2016
DNSP notifies AER on need for changes to framework and approach	31 Oct 2016
AER consults on need for changes to components of framework and approach	30 Nov 2016
AER issues notice on need for framework and approach	31 Dec 2016
AER position paper on framework and approach	Not prescribed
AER 2017 final determination	30 Apr 2017
DNSP submits forecasting methodology	30 June 2017
AER framework and approach paper published	31 July 2017

AEMC analysis of Chapter 6 of the NER.

The overlap is not a problem from a practical point of view. This is because the preliminary stages of the 2019 process that occur before the AER makes the 2017 final determination are not dependent on the 2017 final determination having been made.

The second disadvantage is that a two year regulatory control period generally has weaker incentive properties than a longer period. As discussed in section 2.3, one of the revenue and pricing principles in the NEL is that a network service provider should be provided with effective incentives in order to promote economic efficiency.[27]

27 NEL s. 7A(3).

Network regulation in the national electricity market is based on incentive regulation where network service providers are given an expenditure allowance for a period of time. To the extent a network service provider's actual expenditure is less than this allowance, it keeps the difference for the remainder of the period. To the extent that it is higher, it bears the additional costs until the end of the period. This arrangement provides an incentive for a network service provider to make efficiency gains. Any efficiency gains made by the service provider should ultimately be passed on to consumers in the form of lower network revenues and charges.

Where a regulatory control period is shorter, a network service provider does not retain the benefit of any efficiency gains or bear greater than expected costs for as long. Therefore, the shorter the regulatory control period the weaker the incentive is. However, the AER could apply efficiency incentive schemes to partly mitigate this impact.[28] While these schemes are generally designed to accommodate five year regulatory control periods they can be applied in a way to accommodate a shorter regulatory control period as identified by TasNetworks.[29]

Overall, the Commission considers the disadvantages of the TasNetworks solution to be small and not material compared to the benefits of alignment.

Alternative solution one

As noted above, this solution would require the AER to set a three year regulatory control period for the transmission network in 2019-20.

In addition to aligning the regulatory control periods of TasNetworks' transmission and distribution networks, this option would also more closely align the regulatory control period of TasNetworks' transmission network with those of other transmission network service providers in the national electricity market. This may assist the AER in undertaking benchmarking of these service providers. Further, the small disadvantages of a two year regulatory control period in TasNetworks' solution are not as large under this option.[30]

The key disadvantage with this option is that it would require one more regulatory determination to be undertaken before alignment would occur compared to the TasNetworks solution. This would delay the benefits of alignment.

28 See for example, AER, *Efficiency benefit sharing scheme for electricity network service providers*, November 2013; AER, *Capital expenditure incentive guideline for electricity network service providers*, November 2013.

29 TasNetworks' submission to consultation paper, p2.

30 The disadvantages of a two year regulatory control period are not removed under this option. Although there would be no overlap in determination processes, there would be two transmission determination processes in quick succession under this option. In addition, a three year regulatory control period still has weaker incentive properties than a standard five year regulatory control period.

Alternative solution two

This solution would involve the AER setting the length of the next regulatory control period for TasNetworks' distribution network to seven years. It would remove the issues surrounding shorter regulatory control periods with the other two alternative solutions. However, as there is a longer than normal regulatory control period under this solution, there is a greater risk that assumptions made in a determination, such as projections of demand and labour costs, will be different from what was forecast in the determination. As with alternative option one, one more regulatory determination would need to be undertaken before alignment occurs compared to the TasNetworks solution under this option. This would delay the benefits of alignment.

4.4 Conclusion

Having considered each of the options, the Commission considers TasNetworks' method of achieving alignment will best promote the NEO.

TasNetworks' solution achieves alignment the quickest which means the benefits from alignment can start to be realised earlier. This solution may result in a small increase in administrative burden for TasNetworks, the AER and other stakeholders in the short term due to overlapping determination processes. In addition, the two year regulatory control period for TasNetworks' distribution network in 2017 may have weaker incentive properties than a longer period. However, these issues can be managed and are not significant enough such that alignment should be delayed. In addition, stakeholders did not raise any issues with TasNetworks' solution from a resourcing perspective during consultation on the rule change request.

While alternative solution two has the benefit of aligning TasNetworks with other transmission network service providers in the national electricity market the Commission does not consider this benefit outweighs the costs that would be incurred if alignment was delayed. The AER is able to benchmark regardless of whether the regulatory control periods of the service providers are aligned.

5 Legal drafting

5.1 TasNetworks' view

The proposed rule, included as part of TasNetworks' rule change request, was drafted as a participant derogation from clause 6.3.2(b) of the NER.[31] However, in response to the consultation paper, TasNetworks supported the alternative drafting proposed by the AEMC.[32]

5.2 Stakeholder views

The ENA considered the alternative drafting proposed by the AEMC would achieve the desired outcome.[33]

5.3 Analysis and conclusion

Under the NEL, a person conferred a right, or on whom an obligation is imposed under the NER, may request the AEMC to make a participant derogation that relates to that person.[34]

The Commission considers that clause 6.3.2 does not provide a right or obligation on TasNetworks from which a derogation could be possible. The proposed rule is therefore not appropriately drafted as a participant derogation and has been redrafted. The redrafting of the proposed rule has been designed to implement the policy objective in the rule change request and proposed rule. The rule requires the AER to set the next regulatory control period for TasNetworks' distribution network to two years.[35]

In terms of implementation, putting the rule in place now provides sufficient time for TasNetworks to take the two year regulatory control period into account in preparing its distribution regulatory proposal.[36]

31 NER clause 6.3.2 requires a regulatory control period to be at least five years.

32 TasNetworks' submission to consultation paper, p2.

33 ENA submission to consultation paper, p1.

34 NEL s. 91(5).

35 The next regulatory control period for TasNetworks' distribution network will commence on 1 July 2017.

36 TasNetworks is required to submit its distribution regulatory proposal by 31 January 2016.

Abbreviations

AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
ENA	Energy Networks Association
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEO	national electricity objective
NER	National Electricity Rules
TasNetworks	Tasmanian Networks Pty Ltd

A Legal requirements under the NEL

This appendix sets out the relevant legal requirements under the NEL for the AEMC to make this draft rule determination.

A.1 Final rule determination

In accordance with s. 102 and s. 103 of the NEL the Commission has made the final rule determination and associated final rule in relation to the rule proposed by TasNetworks.

The Commission's reasons for making this final rule determination are set out in Chapters 3, 4 and 5.

A copy of the rule as made is attached to and published with this final rule determination.

A.2 Power to make the rule

The Commission is satisfied that the rule as made falls within the subject matter about which the Commission may make rules. The rule as made falls within the matters set out in s. 34 of the NEL as it relates to the activities of persons involved in the operation of the electricity system. Further, the rule as made falls within the matters set out in clauses 15, 17, 25, and 26A of schedule 1 of the NEL. The rule as made falls within these matters as it relates to the timing of AER revenue determinations for TasNetworks' transmission and distribution networks.

A.3 Commission's considerations

In assessing the Rule Change Request the Commission considered:

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

There are no relevant MCE statements of policy principles relating to this rule change request.[37]

The Commission may only make a rule that has effect with respect to an adoptive jurisdiction if satisfied that the proposed rule is compatible with the proper performance of the Australian Energy Market Operator's declared network functions.[38] The rule as made is compatible with the Australian Energy Market Operator’s declared network functions because it does not affect the performance of those functions.

A.4 Civil penalties

The rule does not amend any clauses that are currently classified as civil penalty provisions under the NEL or National Electricity (South Australia) Regulations. The Commission is not recommending to the COAG Energy Council that any of the amendments made by the rule be classified as civil penalty provisions.

37 Under s. 33 of the NEL, the AEMC must have regard to any relevant MCE statements of policy principles in making a rule. The MCE is referenced in the AEMC’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.

38 See s. 91(8) of the NEL.