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Department of Industry
Tourism and Resources

Chapter 6 of the National Electricity Rules - Distribution Revenue and Pricing Rules



Purpose of the presentation

- Clarify what was intended
- SCO's response on NEL (Amendments)
- Give a better understanding on the distribution rules to assist submissions due on 25 May
 - Structured to follow explanatory materials
- Please ask questions



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NEL (Amendments)

SCO response



National Electricity Law Framework

- To implement the transfer of functions, response to Expert Panel and Merits Review: the NEL is being amended.
- An Exposure draft was released in January 2007 and SCO responded to submissions in April 2007.
- The economic regulatory rules need to be understood in the context of the NEL Amendments and the SCO Response.



Enshrining Key Economic Principles

Law and Rules to be underpinned by key economic concepts:

- Objective of the Law
- Revenue and Pricing Principles
- Form of Regulation Factors
- These are implemented in the Rules.



Information Regime

- NEL establishes power for regulatory information instruments for the AER to set out detailed information requirements on:
 - Service providers; and/or
 - those businesses who make a material contribution to the provision of regulated services
- Now more explicit consideration of:
 - Costs of complying
 - Whether services supplied on a genuinely competitive basis
- Increased consultation requirements



Access Arbitrations

- NEL will set out enforceable framework for AER to hear access disputes
- Access Disputes are those disputes specified as such under the Rules
- Primary application to distribution businesses – replace Chapter 8 process



Merits Review

- Merits review process streamlined from exposure draft but still designed to balance interests in the process:
 - Clarify costs (not indemnity)
 - Protection for small consumer groups
 - Removal of 'serious issue to be determined'
- Merits review of administrative decisions, not quasi-legislative decisions that apply market wide – eg rule making or determining WACC



Rule Change Process

- Key amendments to the Rule Change process in the NEL:
 - Fast-tracking of proposals already consulted upon (including AEMC reviews)
 - Greater consolidation powers
 - Greater ability for AEMC to respond to issues in submissions
- Will facilitate continued development and refinement of Rules.



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Electricity revenue and pricing rules for distribution



Overview

- Amended Australian Energy Market Agreement
 - MCE develop the initial Chapter 6 of National Electricity Rules, "Economic Regulation of Distribution Services".
 - Once initial rules in place the AEMC, as the rule maker, will be responsible for assessing rule change proposals against the NEL objective.
 - AER as national economic regulator will apply them.



Approach to distribution rules

- Distribution revenue and pricing rules
 - Build on the AEMC approach to electricity transmission
 - Differences where appropriate, to reflect:
 - The nature of the distribution networks
 - The diversity of the customer base compared to transmission network
 - Transition from state-based regulation to the national framework



Part B – Classification of Distribution Services and Distribution Determinations

- Determines the process by which Form of Regulation and Form of Price Control decisions are made.
- Note change in terminology from current NER,
 - "Prescribed services" now "Direct control services".
 - "Direct control services are split into "standard control services" and "alternative control services".



Part B – Classification of Distribution Services and Distribution Determinations (cont.)

- "Form of Regulation" decision - how services will be categorised into no regulation, direct control and negotiate arbitrate.
- "Control setting methodology" - process by which services are classified as standard or alternative forms of control.
- "Form of Price Control" - determines whether a price cap, revenue cap or hybrid model is adopted for service under a building block form of regulation.

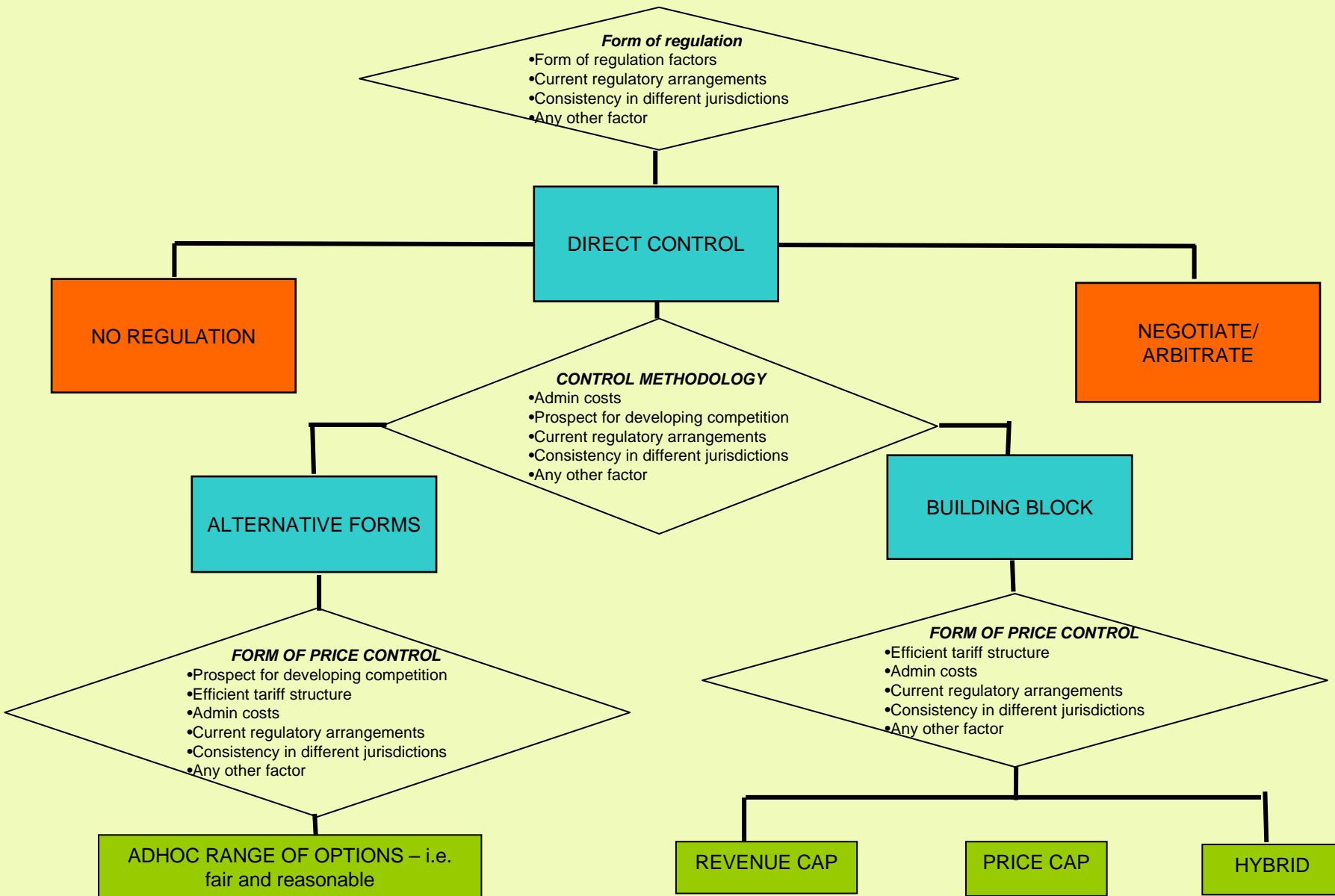


Part B – Classification of Distribution Services and Distribution Determinations (cont.)

- Key points.
 - Distribution differs from transmission as Form of Regulation and Form of Price Control decision are not prescribed in the rules.
 - Decisions are guided by criteria.
 - Current differences between jurisdictional arrangements.

NEL OBJECTIVE PRICING PRINCIPLES

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Basis of Control Mechanisms – 6.2.6

- Standard Control = Building Block CPI – X
 - Equalise in present value terms the revenue over the period
- Alternative Control = basis in determination



Guidelines 6.2.8

- AER may publish general and specific non-binding guidelines about the exercise of its discretion
 - Particular use for classification and form of price control
- These guidelines do not bind or impose obligations of service providers or other parties
- Guidelines need to be consulted upon.



Part C – Revenue Regulation for Standard Control Services

- Key Points
 - Mainly follows transmission rule approach.
 - Develops revenue requirement through a building block control method for standard control distribution services.
 - Transmission rules based on a revenue cap. Distribution rules differ to accommodate the range of control methods.



Part C – Revenue Regulation for Standard Control Services (continued)

- Asset base - 6.5.1
 - Opening asset values will be specified in the rules – consistent with AEMC transmission rules
 - Initial rules will prescribe a roll forward approach
 - The asset base can be adjusted to cater for movement of distribution services between different forms of regulation
- Depreciation – 6.5.3
 - Rules to recognise depreciation
 - Depreciation to be calculated over the economic life of asset or category of assets.



Part C – Revenue Regulation for Standard Control Services (continued)

- WACC
 - Distribution rules provide for post-tax nominal WACC – transitional issues are relevant given differences between jurisdictions currently
 - WACC parameters will not be prescribed in Rules – different values have been adopted previously in distribution
 - 5 year reviews
 - Align with AER WACC transmission reviews



Part C – Revenue Regulation for Standard Control Services (continued)

- Operating and capital expenditure framework - 6.5.6
 - Transmission opex and capex principles and decision making framework have been adopted for distribution
- Capital expenditure - 6.5.7
 - Ex ante framework
 - No contingent project regime given nature of distribution



Part C – Revenue Regulation for Standard Control Services (continued)

- Cost pass throughs - 6.6.1
 - Events specified in rules with ability for AER to add additional events in regulatory determination

- Re-opening provisions - 6.15
 - AER to revoke and substitute when factual error or false or misleading information
 - Consistent with NGL



Part C – Revenue Regulation for Standard Control Services (continued)

Incentive schemes

- Opex efficiency benefit sharing mechanism - 6.5.5
 - Consistent with transmission revenue rules
- Capex benefit sharing mechanism
 - Ability for the AER to develop a mechanism for capex
 - Adopted by jurisdictional regulators in distribution



Part C – Revenue Regulation for Standard Control Services (continued)

- Service target performance incentive scheme – 6.6.2
 - Includes financial service standards framework (s-factor)
 - Consultation with jurisdictions
 - Applies 'distribution service standards'



Part D – Negotiated distribution services

- Key points
 - Distribution framework largely consistent with transmission negotiate/arbitrate rules
 - General pricing principles based upon the transmission negotiate/arbitrate principles
 - Requirement for DNSP to prepare negotiating framework at same time as revenue proposal submitted
 - Arbitration frameworks differ between transmission and distribution
 - AER binding arbitrator for access disputes
 - Small customer dispute resolution schemes (i.e. Ombudsman) will retain their current jurisdiction
 - Commercial arbitration will be available to the parties.



Part E – Regulatory Proposal

- Key points
 - Issues papers may be published by AER at least 5 months prior to application for the next regulatory reset.
 - Full application to be lodged 13 months prior to the next regulatory reset or within 3 months of being required to do so by AER. This application must include,
 - Proposed form of regulation decision - What distribution services fall within direct control (i.e. building block, alternative forms), negotiate/arbitrate, no regulation
 - Proposed for Form of Price Control Decision – Whether a revenue cap, price cap or a hybrid will be applied.



Part E – Regulatory Proposal (continued)

- Proposed setting of revenue/price for services.
- Makes use of information disclosure provisions in the NEL



Part F

- There is no Part F in the rules replicating information disclosure requirements in Part F in the transmission rules, because information disclosure has been elevated to the NEL.



Part G – Cost Allocation

- Key points
 - Costs are allocated according to the same cost allocation principles as those used in transmission.
 - The AER must make cost allocation guidelines, relating to the preparation of a cost allocation method by the DNSP.
 - Each DNSP must submit its cost allocation method to the AER within twelve months of the commencement of the rules.
 - The DNSP may amend its cost allocation method.



Part H – Distribution Consultation Procedures

- Key Points
 - The AER must consult when developing any proposed guideline, model, scheme, amendment or revised value or method.
 - When being applied exclude the need to use consultation rules in 8.9 of the NER.



Part I – Ring-Fencing Arrangements for Distribution Network Service Providers

- Key Point
 - Current ring fencing arrangements to remain in place until legislative package dealing with non-economic distribution and retail regulation commences



Part J - Distribution Pricing Rules

- Key Points
 - The emphasis of Part J is on principles that will lead to efficient network tariffs for direct control services, but not negotiated services.
 - Differences between transmission and distribution affect need for prescriptive pricing rules and compliance arrangements.



Differences between transmission & distribution

- Distribution networks
 - Highly meshed
 - Incremental augmentations
 - Large number of customer connections
 - Both price cap and revenue cap form of price control
- Transmission networks
 - Relatively less meshed
 - Lumpy augmentations
 - Very few customers
 - Revenue cap form of price control



Part J - Distribution Pricing Rules (continued)

- Pricing principles,
 - ensure that the revenue earned from each customer or customer group are set by reference to the efficient costs incurred in serving that customer or customer group.
 - Ensure that the structure of tariffs is consistent with economic efficiency.



Part J - Distribution Pricing Rules (continued)

- The principles are:
 - (1) The revenue expected to be recovered from a tariff class should lie on or between an upper bound of stand alone cost of serving the customers to whom the tariff class applies, and the lower bound of avoidable cost of not serving the customers to whom the tariff class applies;



Part J - Distribution Pricing Rules (continued)

- (2) For each tariff class, the DNSP must:
 - (a) select one or more charging parameters; and
 - (b) set the tariff for each charging parameter,taking into account the long run marginal cost for each element of service having regard to:
 - (c) the transaction costs associated with each parameter; and
 - (d) whether customers are likely to respond to price signals provided to them.
- (3) If the tariffs set under (2) do not recover the expected revenue determined in (1), the DNSP must adjust tariffs to ensure recovery of expected revenue in a manner which seeks to minimise any distortion of efficient patterns of consumption.



Part J - Distribution Pricing Rules (continued)

- Tariff classes. When creating a tariff class identify,
 - Distribution services to which tariff class applies.
 - Customers or class of customers the tariff class contains or identify the customers or class of customers who are eligible to be provided a distribution service.
 - The charging parameters that apply to the tariff class.
- Different tariff classes for standard vs alternative control to avoid cross-subsidisation (but customers can receive both).



Part J - Distribution Pricing Rules (continued)

- Pricing proposal
 - DNSP to submit pricing proposal at same time as it submits its revenue proposal
 - Pricing proposal to set out – tariff classes and proposed charging parameter

- Annual tariff report
 - Submitted to the AER annually
 - Demonstrate annual increases in prices consistent with side-constraints and distribution determination (primary constraint)



Part J - Distribution Pricing Rules (continued)

- Side Constraints
 - Only apply to tariff classes related to the provision of standard control services.
 - Expected weighted average revenue for each tariff class in any year can increase by no more than 2% more than the primary constraint from the previous year.
 - Applies within but not between regulatory periods.
 - Exclusions from the side constraints include,
 - The recovery of revenue to accommodate a variation to the determination.
 - The recovery of revenue to accommodate pass through of TUOS
 - Price differentials resulting from the installation of advanced metering infrastructure.



Part K – Billings, Settlements and Prudential Requirements

- Key Points
 - No changes from current regulatory arrangements.
 - Use of system matters to be considered in non-economic and retail regulation legislative package.
 - Prudential requirements also carried forward .



Part L – Prepayments and Capital Contributions

- Key points
 - Carries forwards Prepayments and Capital Contributions clauses from previous rules.
 - Capital works contributions and issues associated with network expansions (Items 4 and 5 of the AEMA) will be addressed as part of a separate work stream.



Part M – Dispute Resolution

- Key points.
 - Defines an access dispute and determines the process by which it will be resolved.
 - Ensures approved prices must be awarded and negotiated distribution service criteria must be applied.
 - Provides for termination of access dispute where ombudsman scheme applies.



Schedules

- Key points
 - Schedule 6.1 specifies core information requirements for revenue proposals (others in regulatory information instruments).
 - Schedule 6.2,
 - Establishes the opening value of the regulatory asset base,
 - Applies a prudency and efficiency test for new DNSP's



Schedules (continued)

- Defines when assets can be added or removed to the RAB.
Given that there is greater flexibility in the distribution rules in respect to FOR, control setting method and FOPC, there is more flexibility to add or remove assets
- Describes how the RAB will be rolled forward each year



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Questions?