

**Standing Committee of Officials of the
Ministerial Council on Energy**

**Changes to the National Electricity Rules
to establish a national regulatory framework for the
economic regulation of electricity distribution**

Explanatory Material

April 2007

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Glossary

Abbreviations

ACCC	Australian Competition and Consumer Commission
ACT	Australian Competition Tribunal
AEMA	Australian Energy Market Agreement - the intergovernmental agreement between the Commonwealth and all of the States and Territories first made in 2004 and amended in 2006
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
DNSP	Distribution Network Service Provider
Expert Panel	MCE-appointed Expert Panel on Energy Access Pricing
ICRC	Independent Competition and Regulatory Commission
IPART	Independent Pricing and Regulatory Tribunal
MCE	Ministerial Council on Energy
NEL	National Electricity Law, Schedule to the <i>National Electricity (South Australia) Act 1996</i>
NEM	National Energy Market comprising the interconnected jurisdictions of NSW, ACT, Qld, Vic, Tas, SA and the Commonwealth offshore area.
NEMMCO	National Electricity Market Management Company
NER	National Electricity Rules – Statutory Rules made under Part 7 of the NEL
NGL	National Gas Law, Schedule to the proposed <i>National Gas (South Australia) Act 2007</i>
NGR	National Gas Rules – Statutory Rules proposed to be made under Chapter 7 of the NGL
PC	Productivity Commission
SCO	Standing Committee of Officials reporting to MCE
TFP	Total Factor Productivity

Relevant Publications

MCE Decision on Review of Decision-Making in the Gas and Electricity Regulatory Frameworks, June 2006

<http://www.mce.gov.au/index.cfm?event=object.showContent&objectID=839F2DC1-AE13-142E-8425FEF5F2E8C822>

Final Report of the MCE Expert Panel on Energy Access Pricing, April 2006

<http://www.mce.gov.au/index.cfm?event=object.showContent&objectID=B0F3AD4C-A1C6-28DB-CB9CC594D2B88090>

MCE Arrangements for Consumer Advocacy in the Energy Sector, December 2005

<http://www.mce.gov.au/index.cfm?event=object.showContent&objectID=2CB6A5A9-EDA6-E716-FD118AA822DD7665>

Energy Market Reform Bulletin No 68 – Release of MCE Statement of Scope – A National Legislative Framework for Gas and Electricity

<http://www.mce.gov.au/index.cfm?event=object.showContent&objectID=C1CF57E4-D8A3-3039-E47E5E40C3F58B8A>

2006 Comprehensive Legislative Package: Overview and Response to Expert Panel on Energy Access Pricing

<http://www.mce.gov.au/assets/documents/mceinternet/2006ComprehensiveLegislativePackage%5FOverviewandResponsetoExpertPanel20061107112522%2Epdf>

Regulatory Impact Statements on Form of Regulation, Pricing Principles, Information Disclosure and Regulatory Decision-Making, November 2006

<http://www.mce.gov.au/index.cfm?event=object.showContent&objectID=BFE1687D-FD85-42F6-8BF0063BEEFE6846>

NERA Economic Consulting, Distribution Pricing Rule Framework, December 2006

NERA Economic Consulting, Part One Distribution Rules Review – Network Incentives for Demand Side Response and Distributed Generation, April 2007

NERA Economic Consulting, Part Two Distribution Rules Review – Network Incentives for Demand Side Response and Distributed Generation, April 2007

National Electricity Rules Exposure Draft, April 2007

National Gas Rules Exposure Draft, November 2006

<http://www.mce.gov.au/index.cfm?event=object.showContent&objectID=0DCFC892-E1F9-49A9-A8B3529F61C88B39>

Overview

The Commonwealth and State and Territory Governments agreed in the Australian Energy Market Agreement (AEMA) to establish a national framework for the regulation of distribution and retail activities covering both electricity and natural gas.

The changes to the National Electricity Rules (NER) in this package transfer functions for the economic regulation of electricity distribution to the Australian Energy Market Commission (AEMC) and the Australian Energy Regulator (AER). A later package of amendments to the National Electricity Law (NEL) and NER will transfer non-economic regulation of distribution and retail functions (other than retail pricing) to the AEMC and AER.

The Ministerial Council on Energy (MCE) appointed an Expert Panel on Energy Access Pricing to advise on a model to achieve a common approach to revenue and network pricing across the energy market. Based on the Terms of Reference, the Expert Panel's principal role was to develop a common set of arrangements for the economic regulation of access to electricity and gas transmission and distribution networks, covering:

- pricing principles;
- regulatory guidance (i.e. how the principles are applied, the extent of the regulator's discretion, and related matters); and
- any associated changes necessary to established regulatory processes (i.e. the steps in the assessment process, timelines etc).

The Expert Panel consulted with industry and interested stakeholders before presenting its final report to MCE in April 2006. The Expert Panel's recommendations have informed the draft amendment of the National Electricity Law and the Exposure Draft of the electricity distribution Rules (as well as the gas legislative package).

SCO's Network Policy Working Group has also obtained expert advice from NERA Economic Consulting and Allen Consulting Group in developing the exposure draft of the electricity distribution revenue and pricing Rules.

The AEMC had a statutory obligation to revise the NER for the regulation of electricity transmission revenue and pricing. The AEMC undertook an extensive consultation process with stakeholders before finalising the transmission revenue and pricing Rules. The AEMC completed its changes to the NER in December 2006. The transmission revenue Rules were made in National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006 No. 18. The transmission pricing Rules were made in National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No. 22. The transmission rules are contained in a new Chapter 6A of the NER. The AEMC made consequential changes to the distribution rules which are retained in Chapter 6 of the NER.

To achieve the MCE's objective of consistency where appropriate, the Exposure Draft of distribution revenue Rules largely builds on the AEMC's approach to economic regulation of electricity transmission. The Exposure Draft takes into account differences in the nature of transmission and distribution networks, based on analysis of these differences undertaken during the development of the draft Rules.

The exposure draft distribution pricing rules are less prescriptive than the transmission pricing rules. The draft distribution pricing rules articulate a number of principles based on economic efficiency. The rules provide flexibility for the distribution network service

provider to nominate in a pricing proposal to the AER tariff classes, the charging parameters for those tariff classes and assign values to those charging parameters and demonstrate compliance with the pricing principles and the rules. The rules will also contain side constraints which will limit the average increase for the tariff class.

Part A – Introduction

Description of Part A

Clause 6.1.0 contains definitions used in Chapter 6. In the final NER, these definitions will be transferred to Chapter 10.

Clause 6.1.1 Part A describes the AER's economic regulatory responsibility with respect to distribution services.

Clause 6.1.2 Part A describes the structure of Chapter 6.

Part B confers powers on the AER to classify distribution services and make distribution determinations.

Part C regulates revenues that may be earned by Distribution Network Service Providers from the provision of services classified as standard control services.

Part D regulates the prices that may be charged by Distribution Network Service Providers from the provision of services classified as negotiated distribution services.

Part E sets out the procedures for making a distribution determination.

There is no Part F of the rules replicating information disclosure in Chapter 6A because this will be covered by regulatory information instruments under the NEL.

Part G regulated cost allocation.

Part H contains the distribution consultation procedures.

Part I deals with ring-fencing.

Part J deals with tariff classes and tariffs.

Part K deals with billing, settlements and prudential requirements.

Part L deals with prepayments and capital contributions.

Part M deals with dispute resolution.

Clause 6.1.3 Describes the meaning of terms and conditions of access in relation to direct control services and negotiated distribution services.

Clause 6.1.4 Describes the relationship between the DNSP and a service applicant regarding access to direct control services and negotiated distribution services.

Clause 6.1.4(3) will not appear in the final NER. It will be drafted in the NEL consistently with s 110 of the National Gas Law and s 13 of the Gas Pipelines Access Law, but not necessarily in the same words. The clause has been retained in the Exposure Draft of the NER to give DNSPs a concept of the obligation that will be placed upon them.

Part B – Classification of Distribution Services and Distribution Determinations

The current NER

The current NER draws a distinction between *prescribed distribution services* and *excluded distribution services*. Clause 6.2.4(a) (previously 6.10.4(a)) assigns responsibility to the Jurisdictional Regulator to deem which, if any, distribution services are prescribed distribution services (and therefore subject to revenue cap or price cap, or a combination of both under the existing Rules). Clause 6.2.4(b) (previously 6.10.4(b)) deems distribution services that are not prescribed distribution services to be excluded distribution services, which are subject to a more light-handed regulatory approach than revenue cap or price cap regulation. The Jurisdictional Regulator must determine the form of regulation which is to be applied to 'excluded distribution services'. There is currently a wide variety of regulatory approaches dealing with excluded services, some closer to a 'negotiate/arbitrate' framework others a complete, but separate, building block calculation. Clause 6 of Schedule 6.3 (previously Schedule 6.6) of the existing Rules lists services and activities that the Jurisdictional Regulator may define as excluded distribution services, but is not limited to that list.

Policy discussion

The initial distribution Rules will not distinguish between distribution services on the basis of being prescribed, negotiable or excluded services as in the current Rules. Rather, as recommended by the Expert Panel, the initial distribution Rules will distinguish between services on the basis of the form of regulation that will apply to those services, which may be:

- Direct Control (of revenue, or price, or a combination of both);
- Negotiate / Arbitrate; or
- Unregulated.

The initial distribution Rules will not prescribe the form of regulation to be applied to individual distribution services. Instead, the AER, when exercising its regulatory discretion, or the AEMC, when making Rules, will determine how a service should be regulated based on the form of regulation factors prescribed in the NEL. The old terminology of 'prescribed' and 'excluded' services which intersect these categories of regulation have therefore been changed to *direct control services* (including *standard control services* as the old prescribed distribution services and *alternative control services* as those excluded services subject to control regulation) and *negotiable distribution services* as those services where the price may be set in an access dispute. The word 'prescribed' has not been used for *standard control services* because there is no longer any list or instrument that prescribes or lists those as fully regulated. Services that are not classified will be unregulated.

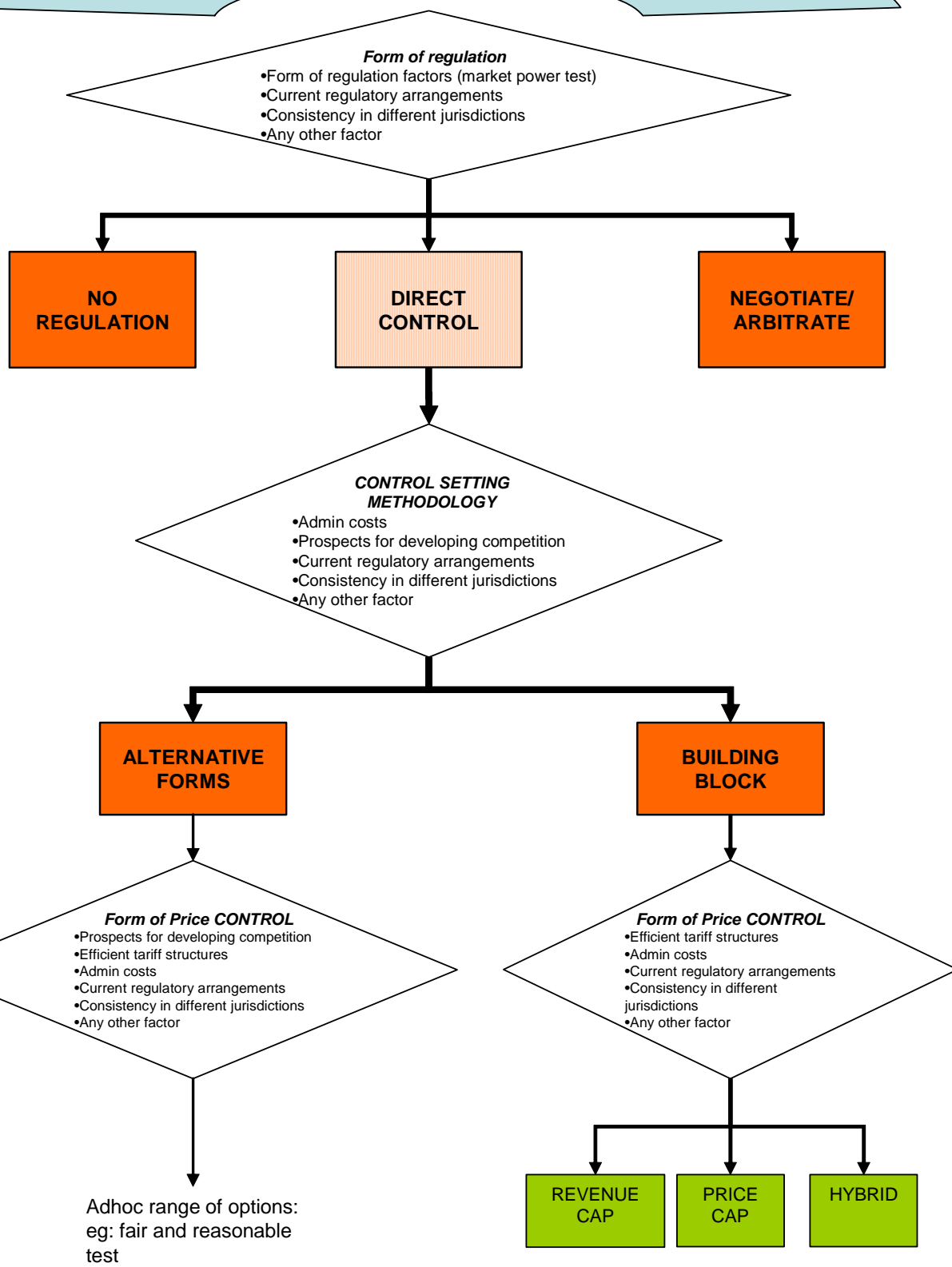
It is intended that the new classifications of services and their relationship to the distribution network service provider's market power in providing each service, will clarify how appropriate regulation is applied for businesses, users and consumers.

The criteria for distinguishing between standard control services, which exhibit a high degree of market power and little or no prospect of competition, and alternative control services, which exhibit varying degrees of residual market power to warrant lighter-handed regulatory intervention, are:

- (1) the potential for the development of competition in the relevant market;
- (2) the administrative costs of the AER, the DNSP and users or potential users;
- (3) the current regulatory arrangements applicable to the service;
- (4) the need for consistency in the regulatory arrangements for similar services ; and
- (5) any other factor the AER considers relevant.

A diagram summarising the form of regulation factors and the flow on effects for the control setting methodology and form of price control decisions is below.

NEL Objective and Pricing Principles



Jurisdictional Regulators have a range of existing arrangements in place for excluded services, which would make it impractical to attempt to list excluded services in the initial distribution Rules.

Unregulated Distribution Services

Control or Negotiate / Arbitrate are not applicable forms of regulation for a distribution service provided in an effectively competitive market. The seekers of the service have alternative service providers with whom to negotiate provision of the service. Therefore, the Rules provide for unregulated distribution services. For clarity, a service may be unregulated in terms of price, but may be regulated in other aspects (e.g. if the service co-utilises assets which are also utilised to provide regulated services).

Description of Part B

Clause 6.2.1 The AER may classify each distribution service to be provided by a DNSP as:

- (1) a direct control service; or
- (2) a negotiated distribution service.

If the AER does not classify a distribution service as either a direct control service or a negotiated distribution service, then it is an unregulated distribution service.

In making the classification, the AER must have regard to:

- (1) the form of regulation factors in the NEL;
- (2) the current form of regulation applicable to the service;
- (3) the need for consistency in the form of regulation for similar services ; and
- (4) any other factor the AER considers relevant.

Clause 6.2.2 Direct control services are to be further divided into 2 subclasses:

- (1) standard control services; or
- (2) alternative control services.

In making the sub-classification, the AER must have regard to:

- (1) the potential for the development of competition in the relevant market;
- (2) the administrative costs of the AER, the DNSP and users or potential users;
- (3) the current regulatory arrangements applicable to the service;
- (4) the need for consistency in the regulatory arrangements for similar services ; and
- (5) any other factor the AER considers relevant.

Clause 6.2.3 The classification of distribution services will have effect for the duration of the regulatory control period.

Clause 6.2.4 When making a distribution determination the AER must follow the procedures set out in Part E.

Clause 6.2.5 A distribution determination for direct control services will impose a control mechanism which may consist of:

- (1) a schedule of fixed prices;
- (2) a cap on prices;
- (3) a cap on revenue;

- (4) tariff basket price control;
- (5) revenue yield control;
- (6) a combination of any of the above

In deciding the control mechanism, the AER will have regard to the same factors as in clause 6.2.2, and in the case of standard control services, the additional factor of the need for efficient tariff structures and there is no need to consider the factor concerning developing competition because standard control services should be pure natural monopoly services.

Clause 6.2.6 For standard control services, the control mechanism must be based on an annual revenue requirement derived from the building block method in Part C. For alternative control services, the control mechanism must be stated in the determination and may (but need not be) based on the building block method.

Clause 6.2.7 For negotiated services, a negotiating framework and negotiated pricing criteria are to be determined in accordance with Part D.

Clause 6.2.8 The AER may publish guidelines on its website as to the classification of services, the control mechanisms for direct control services, or on any matter for the purpose of Chapter 6. The AER may also publish guidelines dealing with the calculation of stand-alone cost, avoidable cost and long-run marginal cost with respect to clause 6.7.1(2) and Part J.

The guidelines are not binding on the AER, but if the AER makes a determination not in accordance with a relevant guideline, the AER must give reasons in its determination for departing from the guideline. If the guidelines indicate that there may be a change in the form of regulation on future determinations, the guidelines should, if practicable, indicate how transitional issues are to be dealt with.

In making or amending guidelines, the AER must follow the consultation procedures in Part H.

Part C – Revenue Regulation for Standard Control Services

Part C replaces Part B of Chapter 6 of the current NER (previously Part D of Chapter 6). Part C is the equivalent to Part C in Chapter 6A of the transmission rules.

Policy discussion

The starting point for all of the available price control methods for standard control services is to determine a revenue requirement. Therefore, a common element of regulation between prescribed transmission services (which applies a revenue cap as the price control method) and standard control distribution services is determining a revenue requirement using a building block approach.

The initial distribution rules mainly follow the transmission rule in approach to developing a revenue requirement through a building block control setting method for standard control distribution services. In particular:

- a roll forward of the regulatory asset base;
- the same decision model for approving capital expenditure and operating expenditure
- a post tax revenue model;
- a similar, but not identical, pass through regime.

In drafting the rules in Part C, a number of the rules in Chapter 6A which are based on a revenue cap control mechanism have been generalised to accommodate the range of control mechanisms possible in distribution.

Description of Part C

Clause 6.3 Because revenue capping is not the only available form of price control, the equivalent transmission provision is not replicated in the distribution rules. The same effect is intended to be achieved by clause 6.2.6.

Clause 6.3.1 The DNSP must submit a revenue proposal in order to facilitate the AER making a revenue determination, which is part of a distribution determination.

Clause 6.3.2 This clause specifies the required content of a revenue proposal.

The introductory rules in clause 6A.5.1 of Chapter 6A are not considered necessary for distribution.

Clause 6.4.1 The AER must develop and publish a post-tax revenue model in accordance with the distribution consultation procedure within six months of the commencement of this clause and maintain a model at all times thereafter. The AER may change the model from time to time.

Clause 6.4.2 This clause describes what the post-tax revenue model must contain.

Clause 6.4.3 Describes the components of the building blocks to calculate a revenue requirement for each year of the regulatory control period.

Clause 6.5.1 Describes the regulatory asset base as the assets used by the DNSP to provide standard control services. The AER must develop and publish a roll forward model of the

regulatory asset base within six months of the commencement of this clause and maintain a model at all times thereafter. The AER may change the model from time to time. This clause also describes the required contents of the roll-forward model.

Clause 6.5.2 Defines and sets out the formula used to calculate the weighted average cost of capital (WACC) used to determine the return on investment in the building block calculation. The initial distribution rules will not deem values for the WACC parameters (unlike the transmission rule). The AER must review the WACC parameter values on 1 July 2009 and every five years thereafter. The timing of the review coincides with the timing of the AER's review of transmission WACC parameter values. The draft Rules do not lock in credit ratings for debt risk.

Clause 6.5.3 Depreciation must be calculated, using depreciation schedules nominated by the DNSP, based on the value of assets included in the regulatory asset base at the beginning of each year. Depreciation schedules must be based on the economic life of the assets. There is no equivalent to rule 6A.6.3(c) as it only relates to a small category of high value transmission assets dedicated to a small number of users.

Clause 6.5.4 Defines the formula for calculating the estimated cost of corporate income tax in each year of the regulatory control period. The AER must review the value of the utilisation of imputation credits on 1 July 2009 and every five years thereafter.

Clause 6.5.5 Describes an efficiency benefit sharing scheme that the AER must publish and may apply to the DNSP's operating expenditure. There is also a discretion in 6.5.5(b) to implement an efficiency benefit sharing scheme for capital expenditure if the AER determines this appropriate.

Clause 6.5.6 The DNSP's revenue proposal must include a forecast of operating expenditure for the regulatory control period that the DNSP considers is required to achieve defined operating expenditure objectives. The forecast operating expenditure must comply with the requirements of any relevant regulatory information instrument and be allocated to standard control services in accordance with the cost allocation method for the DNSP. The AER must accept the DNSP's forecast if the AER is satisfied that the total forecast operating expenditure reasonably reflects the defined operating expenditure criteria. If the AER is not satisfied, the AER must not accept the DNSP's forecast and must substitute its own forecast of operating expenditure. In deciding whether or not it is satisfied, the AER must have regard to nine defined operating expenditure factors.

Clause 6.5.7 The DNSP's revenue proposal must include a forecast of capital expenditure for the regulatory control period that the DNSP considers is required to achieve defined capital expenditure objectives. The forecast capital expenditure must comply with the requirements of any relevant regulatory information instrument and be allocated to standard control services in accordance with the cost allocation method for the DNSP. The AER must accept the DNSP's forecast if the AER is satisfied that the total forecast capital expenditure reasonably reflects the defined capital expenditure criteria. If the AER is not satisfied, the AER must not accept the DNSP's forecast and must substitute its own forecast of capital expenditure. In deciding whether or not it is satisfied, the AER must have regard to nine defined operating expenditure factors.

Clause 6.5.8 The revenue determination must include an X factor for each year of the regulatory control period. Note that this clause has less detail than the transmission equivalent 6A.6.8 because of the different control mechanisms available.

Unlike clause 6A.7.1 of Chapter 6A, there is no provision allowing a general reopening of the determination included in the distribution rules.

Unlike clause 6A.7.2 of Chapter 6A, there will not be detailed provisions relating to network support pass through events. These will need to be accommodated as general pass through events under 6.6.1.

Clause 6.6.1 Pass through events for distribution are defined in the Rules. The AER may include additional pass through events in a DNSP's determination. The DNSP may seek to pass through a positive pass through amount to customers. The AER may require the DNSP to pass through a negative pass through amount to customers.

Before making a pass through determination, the AER must consult with the DNSP and any other person that the AER considers appropriate. In making a pass through determination, the AER must take into account the seven defined factors in this clause.

Clause 6.6.2 The AER must develop and publish a service target performance incentive scheme and the parameters for the scheme to provide incentives for DNSPs to maintain and improve services. The AER must develop and publish the first service target performance incentive scheme under the Rules within six months of the commencement of this clause. In formulating the service target performance incentive scheme, the AER must apply the distribution service standards which apply to the DNSP and take account of:

- the regulatory obligations to which the DNSP is subject;
- past performance of the network;
- other incentives available to the DNSP; and
- the need to ensure that the incentives are sufficient to offset any financial incentives the DNSP may have to reduce costs at the expense of service.

Part D – Negotiated Distribution Services – Regulation of Pricing

Part D will replace clause 6.6.7 of Chapter 6 of the current NER.

Policy discussion

The initial distribution Rules will set out general pricing principles for negotiated services that will be based on the principles in the transmission Rules (6A.9.1). There will be a requirement for a distribution network service provider to prepare a negotiating framework.

The AER will be the binding arbitrator for access disputes but small customer dispute resolution schemes (like Ombudsman) will retain their current jurisdiction.

Commercial arbitration will be available to the parties but will not be specifically provided for in the rules. The initial distribution Rules will not constrain the distribution network service provider or the seekers of a service from attempting to resolve disputes through private dispute resolution. Nor will the Rules bind a person acting as a private dispute resolution body in the process to be followed, the information sought from the parties or the criteria for resolving the dispute. These are all matters to be agreed between the parties.

The initial distribution Rules will allow those customers who are already eligible to access the alternative dispute resolution mechanism¹ to bring complaints and disputes regarding of the provision of distribution services to the body responsible for alternative dispute resolution (an energy Ombudsman in most States and Territories). Where the customer is defined by State-based legislation to have mandated access to an alternative dispute resolution scheme, the decision of the body responsible for alternative dispute resolution is binding.

Where the AER acts as arbitrator, the NEL (s 16(2)(a)(ii)) will bind the AER to apply the same revenue and pricing principles as would apply under a control form of regulation. The rules will also set out negotiated distribution pricing criteria matching those in rule 6A.9.1 for electricity transmission. The Rules will also specify the dispute resolution procedure to be followed by the AER. Accordingly, an access dispute may be a dispute with respect to:

- (a) the price which a DNSP proposes to charge a service applicant for a negotiated transmission service, or the amount of any access charge;
- (b) the proposed access arrangements or connection agreements of the service applicant;
- (c) any question as to the fairness and reasonableness of an offer to connect in relation to a distribution network that arises under rule 5.3.6(c);
- (d) access to, connection to, modification of a connection to, or the augmentation of, the provision of network services or distribution use of system services, or the modification of the provision of network services or distribution use of system services, in respect of any distribution network; or
- (e) any combination of the above.

The AER, acting as arbitrator, will be able to require the service provider to provide any service to the applicant. An arbitrator must terminate proceedings if there is effective competition in the provision of the disputed service (s 127).

¹ Eligibility to access the alternative dispute resolution mechanisms are defined under State and Territory-based legislation and will remain so under item 17 of Annexure 2 of the amended AEMA.

Description of Part D

Clause 6.7.1 Pricing Principles for negotiated distribution services:

- (1) the price for a negotiated distribution service should be based on the costs incurred in providing that service as set out in the Cost Allocation method for each DNSP;
- (2) the price for a negotiated distribution service should be at least equal to the avoided cost of not providing the service but no more than the cost of providing it on a stand alone basis;
- (3) if the negotiated distribution service is a shared distribution service that exceeds the network performance requirements that it is required to meet or exceeds the network performance requirements set out in schedules 5.1a and 5.1, the price should reflect the increase in incremental cost of providing the service;
- (4) if the negotiated distribution service is a shared distribution service that does not meet the network performance requirements set out in schedules 5.1a and 5.1, the price should reflect the amount of avoided cost of providing the service;
- (5) the price for a negotiated distribution service must be the same for all users unless there is a material difference in the costs of providing the service to different users or classes of users;
- (6) the price for a negotiated distribution service should be adjusted over time to the extent that the assets used to provide the service are subsequently used to provide services to another person;
- (7) the price for a negotiated distribution service should be such as to enable the DNSP to recover the efficient cost of complying with all regulatory obligations associated with the provision of the service;
- (8) any access charges should be based on the costs reasonably incurred by the DNSP in providing distribution network user access;
- (9) the terms and conditions of access for a negotiated distribution service should be fair and reasonable and consistent with the safe and reliable operation of the power system in accordance with the Rules;
- (10) the terms and conditions of access for a negotiated distribution service (including, in particular, any exclusions and limitations of liability and indemnities) must not be unreasonably onerous taking into account the allocation of risks between the DNSP and the other party, the price of the service and the costs to the DNSP of providing the service; and
- (11) the terms and conditions of access for a negotiated distribution service should take into account the need for the service to be provided in a manner that does not adversely affect the safe and reliable operation of the power system in accordance with the Rules.

Clause 6.7.2 A DNSP must comply with the provider's negotiating framework and the provider's negotiated distribution service pricing criteria when negotiating the terms and conditions of access for negotiated distribution services. The DNSP must also comply with any other applicable requirements in the Rules.

Clause 6.7.3 A distribution determination for a DNSP is to set out requirements that are to be complied with in respect of the preparation, replacement, application or operations of its negotiating framework.

Clause 6.7.4 A distribution determination by the AER will set out the negotiated distribution service pricing criteria that are to be applied by:

- (1) the DNSP in negotiating:
 - (i) the terms and conditions of access for negotiated distribution services, including prices that are to be charged for those services for the regulatory control period;
 - (ii) any access charges which are negotiated by the DNSP during the regulatory control period; and
- (2) the AER in resolving an access dispute between the DNSP and a person who wishes to receive a negotiated distribution service, in relation to:
 - (i) the terms and conditions of access for the negotiated distribution service, including the price that is to be charged for those services by the DNSP;
 - (ii) any access charges that are to be paid to or by the DNSP.

Negotiating framework

Clause 6.7.5 A DNSP must prepare a negotiating framework document setting out the procedure to be followed during negotiations between the DNSP and any person who wishes to receive a negotiated distribution service from the DNSP, as to the terms and conditions of access for provision of the service.

The negotiating framework must comply with the requirements of a distribution determination and must specify the following minimum requirements:

- (1) the DNSP and service applicant must negotiate in good faith;
- (2) the DNSP to provide all the commercial information a service applicant may reasonably require to enable the applicant to engage in effective negotiation with the DNSP, including cost information;
- (3) the DNSP identify and inform a service applicant of the reasonable costs and/or the increase or decrease in costs of providing the service and the DNSP to demonstrate to a service applicant that the charges for providing the service reflect the costs;
- (4) require a service applicant to provide all the commercial information the DNSP may reasonably require to enable the DNSP to engage in effective negotiation with the applicant;
- (5) allow a reasonable period for commencing, progressing and finalising negotiations and require each party to make reasonable endeavours to adhere to those time periods during the negotiation;
- (6) a process for dispute resolution which provides that all disputes as to the terms and conditions of access for provision of the service are dealt with in accordance with in accordance with the relevant provisions of the National Electricity Law;
- (7) arrangements for payment by the service applicant of the DNSP's reasonable direct expenses incurred in processing the application to provide the service;
- (8) a requirement that the DNSP determine the potential impact on other distribution network users of the provision of the service;
- (9) a requirement that the DNSP must notify and consult with any affected distribution network users and ensure that the provision of the service does not result in non-compliance with obligations in relation to other distribution network users under the Rules;
- (10) require the DNSP to publish the result of negotiations on its website.

The negotiating framework must not be inconsistent with any other requirements in the Rules (Rules 5.3, 5.5 and Part C of Chapter 6), and in the event of inconsistency, the other requirements in the Rules prevail. Each DNSP and service applicant who is negotiating for

the provision of negotiated distribution services by the DNSP must comply with the requirements of the negotiating framework in accordance with its terms.

Confidential information

Clause 6.7.6 Commercial information to be provided to a service applicant by the DNSP may be subject to a condition that the service applicant must not provide any part of that commercial information to any other person without the consent of the DNSP.

Conversely, commercial information to be provided to a DNSP by the service applicant may be subject to a condition that the DNSP must not provide any part of that commercial information to any other person without the consent of the service applicant.

Part E – Regulatory Process

There is no equivalent to Part E in the current Chapter 6 of the NER. Part E is the equivalent to Part E of Chapter 6A.

Policy discussion

Procedure

The initial distribution Rules will provide that a distribution network service provider must include the following in its application for a regulatory determination:

- (a) actual capital expenditure over the preceding regulatory control period;
- (b) forecast capital expenditure in each regulatory year over the next regulatory control period;
- (c) depreciation schedules for each regulatory year over the next regulatory control period;
- (d) forecast operating expenditure for each regulatory year over the next regulatory control period; and
- (e) estimated cost of corporate income tax for each regulatory year over the next regulatory control period.

The NEL will provide the AER with the ability to issue distribution information guidelines outlining the information requirements that the AER needs to conduct its functions, including assessing a distribution network service provider's application through regulatory information instruments. The information guidelines could specify in detail the type and form of information that the AER requires for regulatory reporting and for regulatory determinations.

The initial distribution Rules will require a distribution network service provider to lodge its application for a regulatory determination to the AER 13 months prior to the next regulatory reset period.

Information Disclosure

The NEL will adopt the principle that when a distribution network service provider or a third party has failed to provide the AER with information:

- (a) requested by the AER; and
- (b) necessary for the AER to make a regulatory determination

within a reasonable time, the AER will be allowed to make its own assessment of the information sought and use that assessment for the purposes of a regulatory determination (s 28M).

The confidential information provisions will be elevated to the NEL, consistent with the approach taken in the NGL. The NEL (s 28V) will require the AER to consider, when it does not have the consent of the information provider to publish the information, whether to publish confidential information in an aggregated form, or publish the information when the AER is of the view that:

- (i) the disclosure of the information would not cause detriment to the provider; or
- (ii) although the disclosure of the information would cause detriment to the provider that provided it, the public benefit in disclosing it outweighs that detriment.

Description of Part E

Publication of issues papers

Clause 6.8.1 The AER may, but is under no obligation to, prepare and publish regulatory issues papers relevant to DNSPs generally or a particular DNSP. When a regulatory issues paper relates to a particular DNSP, the AER must publish it at least five months before the DNSP is required to submit its regulatory proposal.

Submission of regulatory proposal

Clause 6.8.2 A DNSP must submit a regulatory proposal to the AER for distribution services at least 13 months before the expiry of a distribution determination, or if there is no distribution determination, within three months after being required to do so by the AER.

The regulatory proposal will contain:

- (1) a proposal showing how the distribution services should be classified; and
- (2) for services proposed as standard control services – a revenue proposal and a proposed regulatory control mechanism; and
- (3) for services proposed as alternative control services – a proposed regulatory control mechanism; and
- (4) for all direct control services – a pricing proposal setting out proposed tariff classes, relevant structural information and pricing information for the first regulatory year; and
- (5) for services proposed as negotiable services – a proposed negotiation framework.

The regulatory proposal must comply with and contain information required by any regulatory information instrument.

Preliminary examination

Clause 6.9.1 If the AER determines that a regulatory proposal does not comply with a requirement of the Law, the AER must notify the DNSP of the determination as soon as possible, stating why, and in what respects, the AER has determined the proposal to be non-compliant.

Resubmission of proposal

Clause 6.9.2 A DNSP must, within one month of receiving notice from the AER, resubmit its regulatory proposal in an amended form that complies with the requirements set out in the AER's determination. The DNSP may only make changes to its proposal to address the deficiencies identified in the determination.

Consultation

Clause 6.9.3 The AER must publish, subject to confidentiality provisions, a regulatory proposal submitted or resubmitted to it by a DNSP, together with the AER's proposed negotiated distribution service pricing criteria for the DNSP and an invitation for written submissions, as soon as practicable after the AER determines that the DNSP's proposal is compliant.

Any person may make a written submission to the AER on the DNSP's regulatory proposal or the AER's proposed negotiated distribution service pricing criteria within the time specified in the invitation. The period for submissions must not be less than thirty business days after the invitation for submissions is published.

Draft decision

Clause 6.10.1 The AER must consider any written submissions and make a draft decision, in accordance with the Rules relating to draft and final decisions. If the AER refuses to approve aspects of the DNSP's regulatory proposal or the proposed negotiating framework, the AER's draft decision must include details of the changes required or matters to be addressed before the AER will approve the amounts or values or the framework.

Publication of draft decision and consultation

Clause 6.10.2 The AER must publish:

- (1) its draft decision and its reasons;
- (2) notice of making its draft decision;
- (3) notice of a predetermination conference; and
- (4) an invitation for written submissions on its draft decision

as soon as practicable, but not later than 6 months after the submission of the DNSP's regulatory proposal.

The AER must hold a predetermination conference for the purpose of explaining its draft decision and receiving oral submissions from interested parties. Any person may attend a predetermination conference but the procedure for the conduct of the conference will be at the discretion of the AER representative in attendance.

Any person may make a written submission to the AER on the draft decision. The period for submissions must not be less than forty-five business days after the predetermination conference.

Submission on revised proposal

Clause 6.10.3 The DNSP may submit a revised regulatory proposal to the AER, within 30 days of the publication of the draft decision. The DNSP may only revise the proposal to incorporate the substance of any changes required by, or to address matters in the draft decision. The AER must publish the DNSP's revised regulatory proposal as soon as practicable after receipt by the AER, subject to confidentiality provisions.

Final decision

Clause 6.11.1 The AER must consider any submissions made on the draft decision, or any revised regulatory proposal submitted by the DNSP and make a final decision in relation to the DNSP.

Clause 6.11.2 If the AER's final decision is to refuse to approve an amount or value for annual revenue requirement, network service target performance incentive scheme parameters, efficiency benefit sharing scheme parameters, or the commencement and length of the regulatory control period set out in the DNSP's regulatory proposal (or revised proposal), the AER must include in its final decision a substitute amount or value, which is

determined on the basis of the regulatory proposal and amended from that basis only to the extent necessary to enable it to be approved in accordance with the Rules.

If the AER's final decision is to refuse to approve an amount or value for annual revenue requirement because the AER is not satisfied that the total forecast operating expenditure reasonably reflects the operating expenditure criteria, taking into account the operating expenditure factors, the AER must include in its final decision its reasons for that decision and the forecast of operating expenditure which the AER is satisfied reasonably reflects the criteria, taking into account the factors.

Similar provisions apply to forecast capital expenditure.

If the AER's final decision is to refuse to approve the proposed negotiating framework, the AER must include in its final decision its reasons for its decision and an amended negotiation framework, which is determined on the basis of the regulatory proposal and amended from that basis only to the extent necessary to enable it to be approved in accordance with the Rules.

Clause 6.11.3 The AER must publish notice of making its final decision, and the final decision including its reasons, as soon as practicable but not later than two months before the commencement of the relevant regulatory control period.

Clause 6.11.4 The AER must make the distribution determination to which the final decision relates as soon as possible after the final decision is made.

Clause 6.12.1 A draft or final decision is a decision by the AER on:

- the classification of services;
- the annual revenue requirement for each regulatory year;
- the values attributed to performance incentive scheme parameters;
- the values attributed to efficiency benefit scheme parameters;
- the commencement and length of the regulatory control period.

In making a decision, the AER:

- either accepts or substitutes the total of forecast capital expenditure;
- either accepts or substitutes the total of forecast operating expenditure;
- determines the control mechanism for direct control services;
- determines the control mechanism for alternative control services;
- either accepts or substitutes the negotiating framework;
- specifies the negotiated distribution service criteria; and
- approves, with or without modification, the DNSP's pricing proposal.

Clause 6.12.2 The reasons given by the AER for a draft decision or final decision must set out the basis and rationale of the decision.

Revocation and substitution

Clause 6.13 The AER may only revoke and substitute a distribution determination during a regulatory control period where:

- (1) it contains a clerical error;
- (2) it contains an error arising from an accidental slip or omission;

- (3) it contains a material miscalculation of figures or a material mistake in the description of any person, thing or matter referred to;
- (4) it contains a defect in form; or
- (5) the determination has been set on the basis of false or misleading information provided to the AER

and the effect is material.

Miscellaneous

Clause 6.14 The AER may, but is not required to, consider late submissions. The AER may publish issues papers, consultation papers or discussion papers and may hold any conferences or information sessions that it considers appropriate.

The AER must publish a submission (including a late submission), except to the extent that it contains information which has been clearly marked as confidential by the person making the submission. The confidentiality provision does not apply to the extent that any other provision in the Law or Rules permits or requires the AER to publicly release such information.

The AER may give such weight to confidential information as it considers appropriate, having regard to the fact that such information has not been made publicly available.

Part F

There is no equivalent to Part F of Chapter 6A because the provisions in the NEL dealing with confidentiality and regulatory information instruments will cover off on these matters.

Part G – Cost Allocation

Clause 6.5 of the current Chapter 6 deals with cost allocation in the context of distribution pricing. Part G is the equivalent of Part G of Chapter 6A in the current NER.

Policy discussion

The Cost Allocation Principles in Part G follow those in Chapter 6A for transmission (recognising that distribution has not maintained the concept of prescribed services). Part G also follows the transmission rule by requiring the AER to issue Cost Allocation Guidelines and the service provider submitting a Cost Allocation Method consistent with the Guidelines, for approval by the AER. The DNSP's Cost Allocation Method will need to recognise the classification of services into standard control services, alternative control services, negotiated distribution services and unregulated services.

Description of Part G

Clause 6.15.1 A DNSP must comply with the Cost Allocation Method that has been approved in respect to the DNSP from time to time by the AER.

Cost Allocation Principles

Clause 6.15.2 The following principles constitute Cost Allocation Principles:

- (1) the detailed principles and policies used by a DNSP to allocate costs between different types of services must be described in sufficient detail to enable the AER to replicate outcomes through application of those principles and policies;
- (2) the allocation of costs must be determined according to the substance of a transaction or event rather than its legal form;
- (3) only those costs that are directly attributable to the provision of a service and costs which are incurred in providing those services may be allocated to a particular category of distribution services;
- (4) any Cost Allocation Method which is used, the reason for using that method and the numeric quantity of the chosen allocatur must be described;
- (5) the same cost must not be allocated more than once;
- (6) the principles, policies and approach used to allocate costs must be consistent with the Distribution Ring-Fencing Guidelines;
- (7) costs which have been allocated to a particular service cannot be reallocated to another service during the course of a regulatory control period.

Cost Allocation Guidelines

Clause 6.15.3 The AER must make Cost Allocation Guidelines relating to the preparation by a DNSP of its Cost Allocation Method, in accordance with the distribution consultation procedures. The AER must develop and publish the first Cost Allocation Guidelines within six months of the commencement of the Rules. The AER may amend or replace the guidelines from time to time but must maintain a set of guidelines at all times after the publication of the first guidelines. The clause also includes matters that the guidelines may specify.

Cost Allocation Method

Clause 6.15.4 Each DNSP must submit a proposed Cost Allocation Method to the AER within twelve months of the commencement of the Rules. The cost allocation method must be consistent with the Cost Allocation Guidelines. The AER may approve or refuse to approve a DNSP's proposed Cost Allocation Method and give notice to the DNSP of its decision within six months of its submission. If the AER does not give notice within the six months, the AER will be taken to have approved the DNSP's proposed Cost Allocation Method.

The AER may amend the Cost Allocation Method submitted to it, in consultation with the DNSP. The amended Cost Allocation Method will need to be approved by the AER.

The DNSP may amend its Cost Allocation Method from time to time and the amendment comes into effect six months after the submission of the amendment to the AER (unless the AER approves the amendment earlier), subject to changes that the AER reasonably considers necessary or desirable, as the AER notifies the DNSP.

The DNSP must amend its Cost Allocation Method to take account of changes to the Cost Allocation Guidelines. The DNSP must maintain a current copy of its Cost Allocation Method on its website.

Part H – Distribution Consultation Procedures

These procedures match the AEMC procedures in Chapter 6A and remove any need for this chapter to refer to the more general rules consultation procedures in 8.9 of the NER.

Policy discussion

The distribution consultation procedures follow the transmission consultation procedures in the NER.

Description of Part H

Clause 6.16 In complying with the distribution consultation procedure, the AER is required publish:

- (1) the proposed guideline, model, or scheme, amendment or revised value or method;
- (2) an explanatory statement; and
- (3) an invitation for written submissions.

The AER may publish issues papers, consultation papers or discussion papers and hold such conferences and information sessions as it considers appropriate.

The AER must publish its final decision within eighty business days of publishing the documents in (1), (2) and (3) above, and give reasons for its decision.

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

The rules in Part I retain clauses 6.12.1 and 6.12.2 in Part E existing NER.

Policy discussion

Current ring-fencing requirements will remain in place until the legislative package dealing with non-economic distribution and retail regulation is legislated. SCO's intention is to develop a consistent, national framework for ring-fencing as part of this upcoming package.

Description of Part I

Clause 6.17.1 All DNSPs must comply with the Distribution Ring-Fencing Guidelines.

Clause 6.17.2 The AER must develop ring-fencing guidelines for accounting and functional separation of a DNSP's direct control services from its other services. The guidelines may include provisions defining the need for and extent of legal separation of the entity through which the DNSP provides network services from any other entity through which it conducts business, the establishment and maintenance of consolidated and separate accounts for direct control services from other services (and for standard control services from alternative control services), the allocation of costs between direct control services and other services (and between standard control services and alternative control services), limitations on the flow of information between the DNSP and any other person, and limitations on the flow of information between those parts of the DNSP's business which provides direct control services and parts that provide other services where there is potential for a competitive disadvantage.

The guidelines may allow the AER to add to or waive a DNSP's obligations under the guidelines.

Under the draft Rules, the AER must consider the need for consistency between the transmission ring-fencing guidelines and the distribution ring-fencing guidelines. In developing or amending the guidelines the AER must consult with participating jurisdictions, registered participants, NEMMCO and other interested parties, in accordance with the distribution consultation procedures. It is not expected that the AER would develop ring-fencing guidelines until the legislative package dealing with non-economic distribution regulation and retail regulation is in place.

Part J – Distribution Pricing Rules

Part J replaces Part C of the current NER. Clause 6.19 retains clause 6.10 (previously 6.18) Data Requirements of the current NER.

Policy discussion

The transmission pricing rule developed by the AEMC adopted a principle-based approach, eliminating a substantial component of the rules containing prescriptive cost allocation methodologies. Like the transmission rules, the distribution pricing rules in Part J also adopt a principle-based approach. While the differences in the nature of transmission and distribution preclude a common approach being taken (refer to Tables 1 and 2 of this document), a similar outcome has been achieved. In particular, prescriptive cost allocation rules have been eliminated.

The emphasis in Part J is on principles that will lead to efficient network tariffs.

Clause 6.10 of the current Rules is retained to ensure workability of the new distribution pricing Rules and Chapter 5 of the Rules.

The advice from NERA that underpinned the development of this chapter has been released with these materials to assist stakeholder understanding of the clauses.

Description of Part J

Clause 6.18.1 Part J applies to tariffs and tariff classes related to direct control services (i.e. both standard control services and alternative control services), but not to negotiated distribution services.

Clause 6.18.2 Provides some definitions used in Part J.

Clause 6.18.3 A DNSP must submit a pricing proposal to the AER annually two months before the commencement of the regulatory year. The clause sets out the content of the pricing proposal. The AER may only approve the pricing proposal if:

- the proposal complies with the Rules and an applicable distribution determination; and
- all forecasts associated with the proposal are satisfactory to the AER.

Clause 6.18.4 A DNSP may divide its customers for standard control services and alternative control services into mutually exclusive tariff classes, having regard to the need to group customers together on an economically efficient basis and the need to avoid unnecessary transaction costs.

Clause 6.18.5 Outlines the pricing principles with which a tariff class must comply. 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;
- (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.

Clause 6.18.6 A side constraint will apply to tariff increases for standard control services. The expected weighted average revenue amount for each standard control service tariff class for the second and subsequent year of the regulatory control period must not be more than 2 percent greater than the CPI-X constraint for that year in comparison to the expected weighted average revenue amount of the equivalent tariff class in the previous year.

The side constraint of CPI-X+2% does not apply to the extent to which the application of the side constraint will not allow the recovery of revenue accommodating:

- any variation to the determination under clause 6.6 (pass throughs);
- any variation to the determination under clause 6.13 (revocation and substitution);
- any arrangements for the automatic pass through of transmission use of system services to customers; or
- price differentials resulting from the installation of remotely read interval metering or of other similar metering technology.

Relaxing the side constraint in these circumstances allows the DNSP to recover costs outside the DNSP's control, such as an increase in transmission use of system charges as a result of a transmission regulatory reset. Otherwise, the side constraint would not allow the DNSP's revenue to increase sufficiently to recover those costs.

Note that the second component of side constraints, which was foreshadowed in the explanatory material for the NEL, released in January 2007, has been removed from the exposure draft of the NER. The second component was a constraint of CPI-X+3.5% on the increase of any charging parameter in a tariff class. Consultation on the NEL indicated that this constraint would impede implementation of demand side response initiatives and the utilisation of smart metering without any corresponding consumer benefit.

Clause 6.18.7 If the AER determines that a pricing proposal does not conform with the Part J, the DNSP must resubmit the pricing proposal within 28 days with amendments necessary to correct the deficiencies identified in the AER's determination and make no other amendments (unless permitted by the AER). If the DNSP fails to comply with this clause, or the resubmitted proposal fails to correct the deficiencies on the former proposal, the AER may itself amend the proposal to bring it into conformity. An approved pricing proposal takes effect at the commencement of the regulatory year.

Clause 6.18.8 The DNSP must maintain on its website the current tariff classes and the tariffs associated with each tariff class and the charging parameters and elements of service associated with each tariff. The pricing information for a particular regulatory year must be posted on the website two months before the commencement of the regulatory year, or that is not practicable, as soon as practicable.

Clause 6.19 Covers the information required by the DNSP to price distribution services.

Part K – Billing Settlements and Prudential Requirements

Part K retains clause 6.8 (previously 6.16) Billing and Settlement Process and clause 6.7.1 (previously 6.15.1) Distribution Network Service Provider Prudential Requirements from the current NER.

Policy discussion

These provisions are not directly related to distribution revenue and pricing, but as part of the current Chapter 6, the provisions need to be retained in the initial distribution Rules.

There is no intention to change regulatory arrangements in relation to distributor billing at this point in time. Therefore the current provisions are carried forward without change. Use of system matters are being considered as part of the non-economic and retail regulation legislative package.

The current provisions in clause 6.7 are also carried forward. However, capital works contributions (covered by Item 4 of Annexure 2 of the Australian Energy Market Agreement (AEMA)) and determining when extensions are part of a regulated service and how charges are levied for distribution network expansion (covered by Item 5 of the AEMA) will need to be revisited in the non-economic and retail regulation legislative package. SCO will engage on separate consultation on these issues with the assistance of independent economic advice. A decision will then be made on the extent to which changes will be implemented through MCE-initiated rule changes or as part of the non-economic distribution and retail package.

Description of Part K

Clause 6.20.1 Requires the DNSP to bill embedded generators a fixed annual entry charge and a use of system charge based on nominated capacity, and bill distribution customers a demand-based price, an energy-based price, a fixed periodic charge and other charges by agreement.

Clause 6.20.2 Specifies the minimum information that must be provided on a DNSP's bill.

Clause 6.20.3 Covers billing to other DNSPs.

Clause 6.20.4 Requires distribution network users to pay distribution service charges by the due date specified on the bill.

Clause 6.21.1 Permits a DNSP to apply prudential requirements on an embedded generator or distribution customer.

Part L – Prepayments and Capital Contributions

Part L retains clauses 6.7.2 and 6.7.3 (previously 6.15) Distribution Network Service Provider Prudential Requirements from the current NER.

Policy discussion

Item 4 of Annexure 2 of the AEMA Connection and capital contribution requirements – new connection charges and capital works contributions - and Item 5 of Annexure 2 of the AEMA Distribution network expansion – determining when expansions are part of a regulated service and how charges are levied - are intended to become part of the national framework for distribution and retail. However, they will not be included in the legislative package of which this exposure draft of the NER is part.

The clauses in Part L retain the essence of the existing clauses 6.7.2 and 6.7.3, amended only to make reference to direct control services. For reference, the existing clause 6.7.1 has been retained in Part K of this exposure draft.

Description of Part L

Clause 6.22.1 Describes the relationship between capital contributions, prepayments and financial guarantees and annual revenue requirement to avoid the DNSP receiving two funding streams for the same asset.

Clause 6.22.2 Clarifies the treatment of payments for services provided before the commencement of the NEM.

Part M – Dispute resolution

Dispute resolution by the AER

Clause 6.23.1 Any dispute which may arise between a DNSP and a service applicant as to the terms and conditions of access which the provider proposes to apply to the service applicant for the provision of a negotiated distribution service is an access dispute within the meaning of the term in Section 2A of the NEL. Additionally, access disputes may be initiated in respect of the terms and conditions of direct control network services.

Clause 6.23.2 . The distribution rules will replicate 6A.30.4 of Chapter 6A to ensure that the AER applies the approved prices for direct control network services in an access dispute and the *negotiated distribution service criteria* approved under 6.7.4 when determining prices for negotiable services.

Clause 6.23.3 Sets out how the AER terminates access disputes whether the matter can be resolved by other jurisdictional dispute resolution schemes, such as Ombudsman schemes for small customer disputes.

To avoid duplication of dispute resolution mechanisms, distribution services access disputes will be excluded from the Chapter 8 dispute resolution process by a provision similar to clause 8.2.1(h)(14). This is not included in the exposure draft as it relates to Chapter 8 of the Rules.

Schedule 6.1 – Contents of Revenue Proposals

Schedule 6.1 does not have an equivalent schedule in the existing distribution rules.
Schedule 6.1 of the distribution rules is equivalent to Schedule 6A.1 of the transmission rules.

Description of Schedule 6.1

S6.1.1 Specifies the information that the DNSP must provide in its revenue proposal in respect to its forecast capital expenditure.

S6.1.2 Specifies the information that the DNSP must provide in its revenue proposal in respect to its forecast operating expenditure.

S6.1.3 Specifies the additional information that the DNSP must provide in its revenue proposal. Note that the information in S6.1.3(2) and (3) may need to be provided as part of the first stage proposal referred to in the consultation issue in Part E.

Schedule 6.2 – Regulatory Asset Base

Schedule 6.2 does not have an equivalent schedule in the existing distribution rules.
Schedule 6.2 of the distribution rules is equivalent to Schedule 6A.2 of the transmission rules.

Policy discussion

The distribution rules apply the same model as the transmission rules of defining opening values of the regulatory asset base (RAB) for the AER's first determination for each existing DNSP by reference back to the values used by jurisdictional regulators and rolling forward to take account of capital expenditure, depreciation and disposals.

Given that there is more flexibility in the distribution rules in respect to the form of regulation, control setting method and form of price control for distribution services, there is also more flexibility for removing assets from or adding assets to the RAB in distribution.

Description of Schedule 6.2

S6.2.1 Establishes the opening value of the regulatory asset base (RAB) and the method for rolling forward the RAB between regulatory control periods.

S6.2.2 Applies a prudence and efficiency test for capital expenditure for new DNSPs.

S6.2.3 Defines when assets can be removed from the RAB.

S6.2.4 Describes how the RAB is rolled forward each year within the regulatory control period.

Chapter 10 – Definitions

There are defined terms used in this exposure draft, which are defined in Chapter 10 of the current NER in the context of transmission regulation, or with references to Chapter 6A. The definitions of these terms will be adopted for the Chapter 6 distribution revenue and pricing rules, where appropriate. Appendix A provides a list of the proposed definitions for distribution. These should be read in conjunction with the Exposure Draft of the Rules.

References to Jurisdictional Regulator

The principal function of the Jurisdictional Regulator under the current NER is economic regulation of distribution under Chapter 6. Under the national framework reflected in the NEL amendments and this exposure draft, the role of economic regulator is undertaken by the AER. However, other chapters of the NER confer other functions on the Jurisdictional Regulator. The Jurisdictional Regulator is defined in Chapter 10 and in Chapter 9 Jurisdictional Derogations.

For this Exposure Draft of the NER, references to the Jurisdictional Regulator in other Chapters of the NER and Chapters 9 and 10 have been retained. Nevertheless, in the final NER, it is proposed that references to Jurisdictional Regulator will be revised as follows:

- CI 2.4.2(b) – reference to "jurisdictional regulator" to be replaced with "jurisdiction"
- CI 2.5.1(e) – delete reference to "jurisdictional regulator"
- CI 2.5.1(f) - reference to "jurisdictional regulator" to be replaced with "jurisdiction"
- CI 2.5.2(c) - delete reference to "jurisdictional regulator"
- CI 2.5.2(c) - reference to "prescribed distribution services" should be replaced with "direct control services"
- CI 3.6.2(b)(3) – reference to "jurisdictional regulator" to be replaced with "the AER"
- CI 3.6.3(b)(2)(i) and (ii), CI 3.6.3(f)(2), CI 3.6.3(g)(1) and (2) , and CI 3.6.3(i) - reference to "jurisdictional regulator" to be replaced with "the AER".
- CI 3.13.3(o) - reference to "jurisdictional regulator" to be replaced with "the AER"
- CIs 3.13.12(a), (b), (c)(6), (d)(1), (h), (i), (j) - reference to "jurisdictional regulator" to be replaced with "AER"
- CI 6A.1.4(b) – delete reference to "jurisdictional regulator"
- CI 6A.21.2(a) – delete reference to "jurisdictional regulator"
- CI 7.2.8(f)(1) - reference to "jurisdictional regulator" to be replaced with "jurisdiction"
- CI 7.3.6(f) – delete reference to "jurisdictional regulator"
- CI 7.13(h)(1) the reference to “Jurisdictional Regulators” can be deleted without losing the reference to the Joint Jurisdictional Review of Metrology Procedures: Final Report of October 2004 (‘the **JJR report**’)
- CI 7.14.4(e)(2) – reference to "Jurisdictional Regulators” to be replaced with “AER”
- CI 8.7.6(a) - reference to "jurisdictional regulator" to be replaced with "AER"
- CIs 8.10.2(b)(2), (d), and (f)(4) – delete reference to "jurisdictional regulator" in conjunction with other changes being made to the Advocacy Panel, which is also part of the legislative package.
- Appropriate changes will be made to Jurisdictional Regulator throughout the Chapter 9 Derogations – CI 9.8.5 – Victoria
CI 9.16.3 – NSW
CI 9.23.3 – ACT

CI 9.29.1 – South Australia

CI 9.38.3 – Queensland

CI 9.48.3 - Tasmania

- Definitions – interested party – replace reference to "jurisdictional regulator" with "AER"
- Definitions – local area/local – replace reference to "jurisdictional regulator" with "jurisdiction"
- Definitions – local network service provider - replace reference to "jurisdictional regulator" with "jurisdiction"
- Definitions- Metrology coordinator – replace reference to "the jurisdictional regulator for that jurisdiction" with "NEMMCO"
- Definition – negotiable services – delete reference to "or a jurisdictional regulator (as appropriate). This definition may need to be amended as prescribed distribution services will not be replaced with direct control services"
- Definition - New large distribution network asset - reference to "jurisdictional regulator for a participating jurisdiction in which the relevant distribution network is located" to be replaced with "AER"
- Definition – new small distribution network asset - reference to "jurisdictional regulator for a participating jurisdiction in which the relevant distribution network is located" to be replaced with "AER"
- Definition – prescribed distribution services – the term may be redundant. Note, the rules, other than Chapter 6, use this term in CI 2.5.2(a)(1), CI 2.5.2(a)(3) and CI 2.5.2(b), the references will need to be amended.
- Definition – price cap - reference to "jurisdictional regulator" to be replaced with "AER". Cross referencing will also need to be amended here.
- Definition – regulatory control period - reference to "jurisdictional regulator" to be replaced with "AER". Cross referencing will also need to be amended here.
- Definition - revenue cap - reference to "jurisdictional regulator" to be replaced with "AER". Cross referencing will also need to be amended here.
- Definition – rule bodies – delete reference to jurisdictional regulator.

Chapter 11 – Savings and Transitional Rules

SCO's preference for dealing with savings and transitional issues is to adopt the same convention as the AEMC adopted in the transmission revenue and pricing rules, by including savings and transitional provisions for the initial distribution rules in Chapter 11 of the NER. SCO is considering other options for implementing savings and transitional arrangements if contingencies arise which delay the NER.

At this stage the savings and transitional rules for distribution have not been drafted. This section of the explanatory material provides an outline of one approach to the content of the savings and transitional rules for the purposes of consultation. An exposure draft of the savings and transitional rules is expected to be available for public consultation by the time that the NEL is tabled in the South Australian Parliament or soon thereafter. However, submissions are sought on the savings and transitional arrangements outlined in this explanatory material, to allow SCO to make an informed decision on the savings and transitional provisions to be drafted.

New Chapter 6 does not affect existing distribution revenue or price determinations

The current distribution determinations made by jurisdictional regulators will be enforced under the existing rules until the determinations expire.

Jurisdictions will transfer responsibility for administering current distribution determinations from the relevant jurisdictional regulator to the AER no later than when the retail and distribution functions agreed in the Australian Energy Market Agreement have been transferred to the national framework. Where appropriate and possible, jurisdictions may transfer functions to the AER in advance of this date.

Savings and transitional arrangements common to all distribution businesses

It is recognised that there will be some transitional issues in moving the regulatory arrangements from jurisdictional regulators under the current Chapter 6 Rules (or state-based derogations from Chapter 6) to a national framework under new Chapter 6 Rules with the AER as regulator. Some of these issues will be common for all distribution businesses, while particular issues arise in respect to ACT and NSW distribution businesses, and these are separately addressed below.

Transitional arrangements for ACT and NSW 2009 distribution determinations

The ACT distributor, ActewAGL, and the NSW distributors, Country Energy, EnergyAustralia and Integral Energy, are regulated by the Independent Competition and Regulatory Commission (ICRC) and the Independent Pricing and Regulatory Tribunal (IPART) respectively under the current Chapter 6 of the NER.

The current determinations for ACT and NSW distributors expire on 30 June 2009. For the next regulatory reset to proceed for the regulatory control period commencing 1 July 2009, the AER, the regulated businesses, users and consumers require certainty about the regulatory framework that will apply and the procedure to be followed in making the reset decisions.

This section of the paper outlines one approach for the NSW/ACT transitional arrangements to apply for the upcoming regulatory review. It should be noted that the proposal outlined in this section is not fully endorsed by SCO. SCO is interested in stakeholder views on the proposal in this section prior to finalising its position on these matters.

Form of Regulation, Price Control method and Form of Price Control

It is proposed that the form of regulation that ICRC and IPART applied to distribution services in their last determinations be applied by the AER in the next determinations. That is, the categorisation of services into prescribed distribution services and excluded services by the ICRC and IPART will be maintained by the AER for the next determination.

It is proposed that the price control setting method for the prescribed distribution services will be the building block method based on a post tax revenue model. It is noted that ICRC and IPART used a pre tax revenue model in previous determinations. The price control setting method for excluded services will be the alternative control method in the exposure draft rules. The ACT and NSW DNSPs do not have negotiated distribution services.

Furthermore, the AER will also apply the same form of price control in the next determination as the ICRC and IPART applied in the last determination for standard control services. Namely, the AER will apply an average price cap for ActewAGL and a weighted average price cap for Country Energy, EnergyAustralia and Integral Energy. The form of price control for alternative control services will be left to the AER's discretion in each determination.

Maintaining the current form of regulation and the current form of price control in the first determination by the AER will avoid regulatory uncertainty as to how distribution services will be classified and subsequently regulated. Maintaining the current form of regulation and the current form of price control will expedite the regulatory process by not requiring the AER to apply the form of regulation factors in the NEL and the criteria in the rules for determining the form of price control for the range of distribution services for each distributor. In terms of the consultation question raised earlier in this paper, this transitional arrangement would eliminate the stage 1 decision and allow the businesses to proceed straight to preparing their revenue proposal.

Revenue proposal and pricing proposal

It is proposed that the rule in the exposure draft rule will apply, and the DNSPs will lodge their revenue proposal with the AER 13 months before the expiry of their current determinations. (The DNSPs have indicated that they will lodge their revenue proposal around April 2008). It is proposed that the exposure draft rule will apply for submitting and approving a pricing proposal. Specifically, clause 6.8.2 and Schedule 6.1 will apply in respect to the revenue proposal and clause 6.18.3 will apply in respect to the pricing proposal.

The AER will need to develop its information requirements (possibly in the form of a template) for the content of the revenue proposal to complement the requirements in the initial distribution rules.

Process for making a determination

It is proposed that the exposure draft rule will apply for making a distribution determination for the forthcoming regulatory control period. Specifically, the regulatory process will follow Part E.

Building blocks

Opening Regulatory Asset Base

The exposure draft rules prescribe the values of the opening regulatory asset base. To maintain consistency with the exposure draft rules, the opening regulatory asset base for the next regulatory control period will adopt the values in clause S6.2.1. Those values are the opening values in the jurisdictional regulators' last determination. Those values will be indexed by outturn inflation. Using different values in the transitionals from those set out in clause S6.2.1 would create inconsistency between ACT and NSW distributors and other distributors (when their determinations are made under the exposure draft rules) and would undermine the consistency in approach between the transmission rules and the distribution rules.

The opening regulatory asset base will need to include capital expenditure between 1 July 2004 and 30 June 2009. The exposure draft rules roll-in the actual capital expenditure, but the transitionals should only roll-in to the RAB the capital expenditure which would have been eligible under the jurisdictional regulators' criteria.

The rationale for including capital expenditure that is eligible under the jurisdictional regulators' criteria is that it simulates the regulatory environment in which the investment was made, or will be made. Also, it would have been the criteria that the jurisdictional regulator would apply if it was rolling-forward RAB at the next determination.

Note that the issue of including capital expenditure during the last regulatory control period into the regulatory asset base is a transitional issue for all distribution network service providers (not just ACT and NSW distributors) and the transitional rules will need to address this issue.

The opening regulatory asset base will need to be decreased by depreciation between 1 July 2004 and 30 June 2009. The exposure draft rules use actual depreciation to adjust the RAB at resets, but the transitionals should use the same basis for depreciation as the jurisdictional

regulator would have applied if it was rolling-forward RAB at the next determination. In IPART's case it would have used forecast depreciation i.e. the depreciation allowed in the regulatory control period, as the depreciation amount at roll forward.

The opening regulatory asset base will need to be decreased by asset disposals between 1 July 2004 and 30 June 2009.

Acknowledging that the jurisdictional regulators' past determination would not bind future determinations, the AER will need to make any other adjustments to the RAB at the next determination that the jurisdictional regulators had envisaged in their determinations, policies or guidelines. However, this does not provide an opportunity to re-open the regulatory asset base.

Weighted Average Cost of Capital

The exposure draft rules do not set initial WACC parameters for distribution, leaving the setting of those parameters to the AER's discretion in each determination. However, the exposure draft rules do require the AER to undertake a review of WACC parameters for distribution in July 2009, consistent with the transmission rules.

Stakeholder views are sought on whether the national rules should apply giving the AER the discretion to set the parameters for the purposes of the review or whether the AER be required to adopt the transmission WACC parameters in the transitionals for ACT and NSW distributors. Namely:

Equity beta of 1.0

Market risk premium of 6.0%

Debt as a proportion of the market value of debt and equity of 0.6

Standard and Poors credit rating of BBB+

Tax imputation credit of 0.5

The AEMC, in its draft determination on the transmission revenue rules, noted the Allen Consulting Group's analysis 'that no distinction should be made between electricity transmission and distribution businesses' with respect to credit rating². The AEMC's views did not change in the final determination on transmission WACC parameters.

If the transitional rules do not adopt the transmission WACC parameters for the ACT and NSW distributors, the AER would effectively have to bring forward its comprehensive review of WACC to be able to apply its findings in the ACT/NSW determinations. The rules would still require the AER to undertake a review in July 2009. The AER would be required to undertake two WACC reviews within about eighteen months.

The AER's 2009 review of distribution and transmission WACC parameters is the appropriate forum for the issues to be comprehensively considered. Adopting the transmission WACC parameters as a transitional measure for ACT and NSW distributors does not create a precedent that the AER must treat distribution and transmission the same in future.

The AEMC also considered the argument for the AER to reset the WACC parameters during the regulatory control period to reflect the outcome of its review. The AEMC dismissed the

² AEMC draft determination, July 2006 p64.

argument as being contrary to the incentives which the rules were intending to place on TNSPs. For the same reasons, the WACC parameters applying in a distribution determination should remain in place for the duration of the regulatory control period.

Depreciation

It is proposed that the exposure draft rules will apply for depreciation for the forthcoming regulatory control period. Specifically, clause 6.5.3 will apply.

Corporate Income Tax

It is proposed that the exposure draft rules will apply for corporate income tax for the forthcoming regulatory control period. Specifically, clause 6.5.4 will apply.

An allowance for tax depreciation on the tax value of assets in the regulatory asset base will be based on the tax value of assets adopted by the ACT and NSW businesses for the purpose of calculating tax expense in the case of ActewAGL and tax-equivalent payments in the case of the NSW distributors.

Operating Expenditure

It is proposed that the exposure draft rules will apply for operating expenditure for the forthcoming regulatory control period. Specifically, clause 6.5.6 will apply.

Capital Expenditure

It is proposed that the exposure draft rules will apply for capital expenditure for the forthcoming regulatory control period. Specifically, clause 6.5.7 will apply.

X factor

It is proposed that the exposure draft rules will apply for the X factor for the forthcoming regulatory control period. Specifically clause 6.5.8 will apply.

Cost pass throughs

It is proposed that the exposure draft rules will apply for cost pass throughs for the forthcoming regulatory control period. In addition to the pass through events defined in the exposure draft rules, and events able to be defined by the AER in a determination, the transitionals will require the AER to pass through any Demand Management Levy that is imposed upon any NSW DNSP after the date of the determination.

Subsequent to the passage of the legislative package dealing with non-economic distribution and retail regulation through the South Australian Parliament, if the AER's ring fencing guidelines require the DNSPs to incur costs during the 2009-2014 regulatory control period in order to comply with the guidelines, this would represent a regulatory change event for the purpose of recovering the cost of compliance as a cost pass through.

A change in the AER's ring fencing guidelines could potentially affect all DNSPs. Therefore transitional issues will need to be addressed as part of introducing national ring fencing requirements.

Incentive schemes

In its 2004 determination, IPART foreshadowed a paper trial S-factor on NSW distributors during 2004-09 as an initial step to introducing a network performance incentive scheme. However, the paper trial did not take place. IPART foreshadowed that it would introduce a more extensive service incentive scheme from 2009. It is proposed that the exposure draft rules will apply, allowing the AER to develop, publish and apply a network performance incentive scheme, based on network performance standards set by the NSW Energy Minister for NSW and the Chief Minister for ACT.

IPART's 2004-09 determination applies a D-factor to the weighted average price cap to recognise demand management costs incurred by the DNSP as part of a least cost approach to meeting expected demand. IPART foreshadowed in its determination that it expected at the 2009 reset that the DNSP's forward looking expenditure profiles would include a mix of demand management and network build solutions.

The transitionals will require the AER to allow the NSW DNSP to recover in the first two years of the 2009-2014 regulatory control period, the demand management implementation costs incurred in the last two years of the 2004-09 regulatory control period and foregone revenue as a result of demand management activities. Thereafter, the AER will have discretion as to how it treats demand management (i.e. whether to continue the D factor scheme, modify it or abandon it).

It is proposed that the exposure draft rules will apply, allowing the AER to develop, publish and apply an efficiency benefits scheme.

Pricing Methodology

It is proposed that the exposure draft rules will apply for the pricing principles. Clause 6.18.3 requires a pricing proposal to demonstrate compliance with the rules (including side constraints) and the applicable distribution determination. The actual audited volumes of the regulatory year $t-2$ are to be used to demonstrate compliance (where t is the first year of the regulatory control period).

The DNSPs will be required to lodge an initial pricing proposal for the first year of the regulatory control period and an annual pricing proposal in each subsequent year in accordance with clause 6.18.3 using the CPI-X set in the determination. The AER may approve the DNSP's pricing proposal in accordance with clause 6.18.7.

Side constraints

It is proposed that the exposure draft rules will apply for the side constraints to tariff increases. Specifically, clause 6.18.6 will apply.

Guidelines for ACT/NSW resets

The exposure draft requires the AER to develop guidelines for cost allocation, service standards, efficiency benefit sharing scheme, post tax revenue model and roll-forward models in accordance with Part H. Given that Part H envisages an 80 business day consultation period, and that guidelines must be published at least two months before the lodgement of

revenue proposals, there will not be sufficient time for the AER to develop guidelines for the ACT/NSW resets. It is therefore proposed that guidelines required for these resets will be subject to transitional arrangements as per those in the transmission rules. SCO anticipates that the AER may begin general consultation about the necessary distribution guidelines based on this Exposure Draft of the rules.

Ring Fencing Guidelines

Current ring fencing requirements will remain in place until the legislative package dealing with non-economic distribution regulation and retail regulation is legislated. That legislative package is expected to be passed through the South Australian Parliament and applied through ACT and NSW Application Acts during the current regulatory control period.

It is proposed that the transitionals apply IPART ring fencing guidelines to NSW distributors until a national framework is developed as part of the non-economic distribution and retail legislative package. Similarly, existing ring fencing arrangements will be maintained for ACT until a national framework is developed. The national ring-fencing requirements will further deal with transitional issues that may result in changes in the way that businesses structure or operate.

Cost Allocation Guidelines

The exposure draft rules are based on a separation of costs between standard control services and alternative control services. Revenue (and subsequently prices) for standard control services are based on a building block approach. Revenue or prices for alternative control services may be, but are not required to be, based on a building block approach. Hence the regulatory asset base in the exposure draft rules relates to assets used to provide standard control services.

If the current control setting method is maintained for the regulatory reset (as is proposed), Miscellaneous Services, Monopoly Services and Emergency Recoverable Works are prescribed distribution services and therefore will be regulated as direct control services. (Excluded Services will be regulated as alternative control services).

Under the current IPART determination, even though Miscellaneous Services, Monopoly Services and Emergency Recoverable Works fall within the weighted average price cap, they have their own price caps.³ Ideally, they could be treated as alternative control services in the next determination. However, there is not the historical cost data at this level to separately build up the cost of providing these services. Without the historical cost data for these services and the other individual services that constitute the remainder of prescribed distribution services, it may not be practical to apply the AER's cost allocation guidelines for the next determination.

A practical transitional arrangement will involve two steps. First, continue to apply the IPART Accounting Code of Separation as the cost allocation method in lieu of clause 6.19.4 during the 2009-14 regulatory control period. Second, require the NSW distributors to report their costs annually to the AER in line with the AER's Cost Allocation Guidelines. In this way, both the AER and the DNSPs will gather historical data over the regulatory control

³ IPART, NSW Electricity Distribution Pricing 2004/05 to 2008/09 Final Determination, June 2004 see Clause 5.3 and Annexure 3

period on the costs of providing service at the individual service level, which will facilitate moving Miscellaneous Services, Monopoly Services and Emergency Recoverable Works to alternative control services (out of the primary price cap) and adopting a Cost Allocation Method which is consistent with the AER Cost Allocation Guidelines at the 2014 reset.

The issue is whether costs are allocated to services at the start of the process and, for standard control services, built up using building blocks to reach a revenue requirement for the individual services, or, whether costs are built up using building blocks to reach a revenue requirement for a group of services and the allocation of revenue to particular services is done at the end of the process. The Rules and the AER's Cost Allocation Guidelines imply the former, but the reality is the businesses have not historically collected data with the granularity to support this approach, so the transitional arrangements adopt the latter, but with the requirement to implement the former at the 2014 reset.

Views are sought from stakeholder on the appropriate approach to cost allocation for the purposes of the NSW/ACT transitional arrangements.

Capital contributions

The exposure draft rules do not change the existing Chapter 6 rules for capital contributions. Therefore it is proposed that the existing ICRC and IPART guidelines be used in the next determination and the next regulatory control period and be subject to pass through provisions if the rules subsequently change.

Any change to the regulatory arrangements for capital contributions under a national framework will be an issue for all distribution network service providers (not just ACT and NSW distributors) and will need to be addressed in the transitional rules.

Table 1 – Fundamental differences between distribution and transmission networks

Issue	Transmission	Distribution	Implications
Key role in market	<p>Reliability and security of supply. Increased competition and supply/demand balancing between regions</p> <p>TUOS represents about 8% of average end-user price</p>	<p>Reliability and security for individual consumers and subregions</p> <p>DUOS represents between 40-50% of average end-user price</p>	<p>Transmission can have significant impact on market outcomes. Distribution has little impact on wholesale market.</p> <p>Increased distribution pricing has much higher impact on consumers.</p>
Impacts of under investment	<p>Less reliable supply and system security. Price separation between regions, distorted economic dispatch within regions and redirected generation investment – efficiency risk</p>	<p>Blackouts in service areas and poor quality of supply – security risk</p>	<p>Different stakeholders and political risks for underdevelopment</p>
Key customers	<p>Large generators and distribution networks. Generally registered market participants.</p>	<p>Households, small businesses, industrial and commercial customers, local government for streetlights, embedded generators. Generally not registered market participants.</p>	<p>In negotiation, information and commercial power asymmetry tends to be much higher in distribution. Registered market participants can be influenced by provisions elsewhere in the Rules.</p>
"Lumpiness" of capital assets and investment	<p>Small number of large assets. Investments also governed by Chapter 5 of the NER (including the Regulatory Test).</p>	<p>Large number of smaller assets. Regular investments to facilitate new connections, system augmentation and asset replacement. Chapter 5 provisions (including regulatory test) also apply to investments.</p>	

Table 2 Differences between AEMC transmission rules and distribution economic regulation rules

1	Scope of services falling within each form of regulation	<p>Direct Control Negotiate/Arbitrate Unregulated</p> <p>Services falling within scope of each form of regulation explicitly defined (by reference to services provided).</p> <p>AEMC had regard to the same factors as in the market power test in NEL in formulating service definitions</p>	<p>Direct Control Negotiate/Arbitrate Unregulated</p> <p>Services falling within scope of each form of regulation not defined Services falling within scope of each form of regulation determined by AER applying market power test in NEL.</p>	<p>Control, negotiate/arbitrate and unregulated options are available in both Rules.</p> <p>Differences:</p> <p>(1) Services will not be defined into particular categories in the initial distribution rules.</p> <p>(2) The AER will determine the scope of services falling under each form of regulation for distribution.</p> <p>(3) Services can move between different forms of regulation for distribution without the need for a Rule change.</p> <p>Distribution services are generally greater in number and more diverse than transmission services (regulators have identified at least forty distinct distribution services). Establishing clear service definitions that can be consistently applied across businesses is likely to be difficult, at least initially.</p> <p>The market power associated with the same service differs between distribution businesses, as a result of different market circumstances, eg. different degrees of established competition.</p> <p>Greater scope for future changes in circumstance to warrant movement of distribution services between forms of regulation.</p> <p>Significant variation in current approach between businesses. Providing AER with discretion allows flexibility during transition to greater consistency.</p> <p>Summary: Benefits of allowing for greater flexibility in distribution. Not relevant to the same degree for transmission.</p> <p>Both approaches consistent with Expert Panel recommendation.</p>
2	Control setting methodology	Building block approach mandated in the Rules for all services subject to direct control	Building block approach mandated in the Rules for DUOS services.	<p>Difference:</p> <p>Building block approach is the only method of direct control available for transmission; other</p>

		<p>(cl 6A.5.4) No other methodology available.</p> <p>TFP may be used to support/inform the building block method (6A.6.6, 6A.6.7).</p>	<p>Alternative (ad hoc) approaches also available such as 'fair and reasonable' test for other services subject to direct control. Approach to be determined by the AER.</p> <p>TFP may be used to support/inform the building block method.</p>	<p>control setting methodologies are permitted for distribution</p> <p>The range and variation between different distribution services included within the scope of direct control can be expected to be wider for distribution than transmission, as a result of:</p> <p>(i) the range of services offered by a DNSP being more varied than TNSP services</p> <p>(ii) market circumstances differing more widely across DNSPs.</p> <p>These differences mean that alternative forms of control are likely to be relevant in the case of distribution.</p> <p>(iii) customers for many services being smaller and more diverse, resulting in fewer services being subject to negotiate/arbitrate and more remaining within scope of direct control</p> <p>The greater flexibility in the distribution rules will also assist with transition from the current arrangements, which differ widely between jurisdictions.</p>
3	Form of Price Control	Revenue control required in the Rules	Rules allow AER to determine the appropriate form of price control: Revenue control, price control or combination	<p>Difference:</p> <p>Distribution rules allow the AER to determine the form of price control, which need not be a revenue control</p> <p>The distribution rules allow for more than one control setting method. Different forms of price control may be appropriate under different control methods. Therefore it is appropriate for the rules to contain this flexibility for distribution.</p>
4	Adjustment to regulatory asset base (RAB)	<p>Rules allow for removal of assets subject to commercial stranding, under limited circumstances (cl S6A.2.3).</p> <p>Once assets have entered the RAB for prescribed services they cannot be allocated to negotiated services</p>	<p>No provisions for asset stranding</p> <p>Adjustments made to RAB when services move in/out of control form of regulation.</p> <p>Prescribe adjustments based on deprival value.</p>	<p>Differences:</p> <p>(1) No asset stranding provision in distribution rules.</p> <p>(2) Distribution rules allow for assets to be removed from the RAB and allocated to negotiated services.</p> <p>Fewer distribution assets are likely to be of a substantial size, dedicated to one user, resulting</p>

		(6A.19.2(7)) Assets may be allocated from negotiated services to the RAB for prescribed services (6A.19.2(8))		in a lower risk of commercial stranding. As there are no specific rules relating to prudent discounts, providing incentives for service providers to use these provisions would not be relevant for distribution (as it is for transmission). A difference in the distribution rules from the approach for transmission can be justified on the basis of the above. Both rules allow for assets to be allocated from negotiated services to the RAB. The distribution Rules prescribe a valuation basis for making the adjustment, (ODV) which provides transparency and certainty in the regulatory process. Inclusion of distribution rules to allow assets to be reallocated from the RAB to negotiated services is consistent with the ability for services to move between forms of regulation in the rules.
5	Depreciation	Straight line depreciation prescribed for assets used by single user (or group of users) with indexed value >\$20m (cl 6A.6.3(c)).	No equivalent provision in distribution rules	Difference: Distribution rules do not contain a provision requiring assets used by a single user and valued at >\$20m to be depreciated on a straight line basis. This provision has been adopted in the transmission rules to support the provision in the rules to allow for the removal from the RAB of assets subject to commercial stranding. If there is no equivalent provision in relation to commercial stranding in the distribution rules, the provision in relation to straight line depreciation is also not required.
6	WACC parameters	Single values set in Rules and reviewed by AER every five years. (cl 6A.6.2 and 6A.6.4))	Initially set at discretion of AER for each DNSP (reflecting an efficient service provider operating in the same environment as the regulated business)	Difference: For transmission WACC parameters are set in the rules; for distribution AER has discretion to determine WACC parameters. To date, there has been consistency in WACC parameter values in regulatory decisions for TNSPs but not for DNSPs across jurisdictions.

				The AER review of transmission parameters will also look at distribution parameters to see if a single set of values can be locked in for distribution.
7	Cost pass-through	Cost pass-through allowed in defined circumstances: Network support pass-through (cl 6A.7.2) and defined events (cl 6A.7.3) Process for cost pass-through defined in Rules.	Events can be defined in determinations or otherwise at discretion of AER subject to principles in the Rules. Some key pass through events defined in the Rules. Process for cost pass-through defined in Rules.	Difference: For transmission, eligible cost pass-through events are defined in the Rules. For distribution they are to be determined by the AER, subject to principles in the Rules and some key events. There is no justification in terms of differences in the underlying characteristics of distribution for the rules to differ from those for transmission. However, there has not been a consistent approach by jurisdictional regulators to defining pass-through events for distribution. In transmission there has been consistency, which allows for codification. The distribution rule allows consistency to evolve through AER determinations, which ultimately may be codified in Rules.
8	Contingent projects	Amend determination when contingent projects are triggered (cl 6A.8.2). Available for investment projects for which timing of expenditure is uncertain at the time of the determination (identified by TNSP at time of determination and determined by the AER).	No equivalent provision in distribution Rules.	Difference: No contingent project regime in distribution rules. Transmission capex can be lumpy and strongly influenced by individual projects, which may suffer a range of external impacts on timing and scope. Distribution capex is more predictable through demand trends. Uncertain distribution projects may be accommodated by pass-through.
9	Re-opening of determination	Revoke and substitute a determination where capital expenditure incurred to overcome an unforeseen event. (cl 6A.7.1)	No equivalent provision in distribution Rules.	Difference: No re-opening regime for unexpected capex in distribution rules. Distribution capex is less likely than transmission

				capex to be lumpy and strongly influenced by individual events.
10	Service performance incentives	AER to develop transmission service performance standards scheme, subject to principles in the Rules. (cl 6A.7.4(a)) Scheme focused on reliability and spot price outcomes). (cl 6A.7.4(b)(1)) Revenue at risk set at 5% of maximum allowable revenue. (cl 6A.7.4(b)(3))	AER to develop distribution service performance standards scheme, subject to principles in the Rules. Scheme focused on: network service performance standards; and network customer service performance standards AER to set revenue at risk.	Differences: (1) Focus of each service scheme is on different elements. (2) AER to determine revenue at risk for distribution, rather than this being set in the Rules. Network customer service performance standards for distribution form part of the customer protection regime for end-use customers and reflect a difference in operating environment between transmission and distribution. This is reflected in the role of States and Territories in setting service reliability standards under the AEMA. Distributors businesses vary in terms of cost of meeting service standards vs revenue/cost of incentives and willingness to pay of customers. Policy outcome is best achieved by leaving discretion with AER, rather than prescribing revenue at risk in distribution Rules. Outages in distribution do not generally impact on wholesale price in the way that transmission outages can.
11	Arbitrator under negotiate/arbitrate	Commercial arbitrator appointed by AER, from nominations by TNSP and applicant. (cl 6A.30)	Commercial arbitration available. Ombudsman or AER as binding arbitrator.	Difference: The arbitrator for disputes is a commercial arbitrator for transmission but the AER or ombudsman for distribution. Many distribution customers likely to be of a smaller scale, making the cost and process of commercial arbitration prohibitive.

Appendix A Definitions for distribution rules

This section sets out the definitions that need to be amended or added in light of the distribution revenue and pricing rules.

- **The following terms are already defined in Chapter 10 of the National Electricity Rules and do not require change**

Distribution Network Service Provider – A person who engages in the activity of owning, controlling, or operating a *distribution system*.

Distribution Network User – A *Distribution Customer* or an *Embedded Generator*.

distribution service – The services provided by a *distribution system* which are associated with the conveyance of electricity through the *distribution system*. *Distribution services* include *entry services*, *distribution use of system services* and *exit services* which are provided by part of a *distribution system*.

distribution system – A *distribution network*, together with the *connection assets* associated with the *distribution network*, which is connected to another *transmission or distribution system*.

Connection assets on their own do not constitute a *distribution system*.

CPI – As at a particular time, the Consumer Price Index: All Groups Index Number, weighted average of eight capital cities published by the Australian Bureau of Statistics for the most recent quarter that precedes that particular time and for which the index referred to has been published by the Australian Bureau of Statistics as at that time. If that index ceases to be published or is substantially changed, *CPI* will be such other index as is determined by the *AER* as a suitable benchmark for recording general movements in prices.

distribution network user access – The *power transfer capability* of the *distribution network* in respect of:

- (a) *generating units* or a group of *generating units*; and
- (b) *network elements*,

at a *connection point* which has been negotiated in accordance with rule 5.5.

jurisdictional electricity legislation – Has the meaning given to that term in the *National Electricity Law*.

regulatory obligation – Has the meaning given to that term in the *National Electricity Law*.

regulatory year – Each consecutive period of 12 calendar months in a *regulatory control period*, the first such 12 month period commencing at the beginning of the *regulatory control period* and the final 12 month period ending at the end of the *regulatory control period*.

Tax – Any tax, levy, impost, deduction, charge, rate, rebate, duty, fee or withholding which is levied or imposed by an *Authority*.

WACC- *Weighted average cost of capital*.

- **The following terms will need to be defined in Chapter 10 of the National Electricity Rules.**

distribution services access dispute - A dispute between a *Distribution Network Service Provider* and a *Service Applicant* as to the *terms and conditions of access to direct control services* or a *negotiated distribution services* as referred to in clause 6.23.1, that is for a determination by the AER as an access dispute under the National Electricity Law

distribution determination – has the meaning given in the National Electricity Law, and includes a determination by the AER as described by Chapter 6.

distribution consultation procedures – the procedure set out in Part E of Chapter 6.

negotiated distribution service – means a *distribution service* that is a negotiated service within the meaning of section 2C of the *National Electricity Law*.

Negotiated Distribution Service Criteria – for a *Distribution Network Service Provider* under a *distribution determination*, the criteria set out in that *distribution determination* pursuant to clause 6.9.4.

Negotiated Distribution Service Principles – The principles set out in clause 6.9.1

non-regulated distribution service - means a *distribution service* other than a *direct control service* or a *negotiated distribution service*.

shared distribution service – A service provided to a *Distribution Network User* for use of a *distribution system* for the conveyance of electricity (including a service that ensures the integrity of the related *distribution system*)

alternative control services – A *direct control service* other than a *standard control service*

direct control services – A *distribution service* that is a *direct control network service* within the meaning of section 2B of the *National Electricity Law*

regulatory proposal – A proposal under clause 6.10

distribution revenue proposal – A proposal relevant to the regulation of *direct control services*

distribution revenue determination – A determination referred to in rule 6A.4

Annual revenue requirement –the amount representing the revenue of a Distribution Network Service Provider for each regulatory year of a regulatory control period calculated in accordance with Part C of Chapter 6.

Total revenue requirement –the amount representing the revenue of a Distribution Network Service Provider for a regulatory control period calculated in accordance with Part C of Chapter 6.

Distribution Service Applicant – A person who requests to be provided with a distribution service

Distribution pass through event – means:

- (a) a *distribution regulatory change event*; or
- (b) a *distribution service standard event*; or
- (c) a *distribution tax change event*; or
- (d) a *distribution terrorism event*; or
- (e) an event nominated in a *distribution determination* as a pass through event for the purposes of the determination

Distribution regulatory change event – A change in a *regulatory obligation* which:

- (a) occurs on or after the commencement of the *distribution determination* for the *regulatory control period*;
- (b) substantially affects the manner in which the *Distribution Network Service Provider* provides *direct control services*; and
- (c) results in the provider incurring materially higher or materially lower costs in providing those services, than it would have incurred but for that event,

and a *regulatory change event* does not include an event described in paragraphs (b), (c), (d) or (e) of the definition of *distribution pass through event*.

Distribution service standard event - Any decision made by an *Authority* or any amendment to an applicable law (including, but not limited to, the *National Electricity Law*, the *Rules*, any distribution licence of a *Distribution Network Service Provider* or any applicable *jurisdictional electricity legislation* (as that term is defined in the *National Electricity Law*)) which has the effect of:

- (a) substantially varying the manner in which a *Distribution Network Service Provider* is required to provide any *direct control services* as at the date of the *distribution determination*;
- (b) imposing, removing or varying minimum service standards on or that apply to a *Distribution Network Service Provider* in respect of *direct control service* that are different to the minimum standards applicable to the *Distribution Network Service Provider* as at the date of the *distribution determination*; or
- (c) altering the nature or scope of the *direct control service* provided by a *Distribution Network Service Provider* from those as at the date of the *distribution determination*,

and which results in the *Distribution Network Service Provider* incurring materially higher or materially lower costs in providing *direct control services* than it would have incurred but for that event.

Distribution tax change event – Any of the following:

- (a) a change in (or a change in the application or official interpretation of) a *relevant tax* or the way in or rate at which a *relevant tax* is calculated;
 - (b) the removal of a *relevant tax*; or
 - (c) the imposition of a *relevant tax*,
- which:

- (d) occurs on or after the commencement of the *distribution determination* for the *regulatory control period*; and
- (e) results in the *Distribution Network Service Provider* incurring materially higher or materially lower costs in providing *direct control services* than it would have incurred but for that event.

Distribution terrorism event – An act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of in connection with any organisation or government), which from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear) and which results in a *Distribution Network Service Provider* incurring materially higher or materially lower costs in providing *direct control services* than it would have incurred but for that act.

Distribution positive change event - For a *Distribution Network Service Provider*, a *distribution pass through event* which entails the *Distribution Network Service Provider* incurring materially higher costs in providing *direct control services* than it would have incurred but for that event.

Distribution positive pass through amount – An amount that is not greater than an *distribution eligible pass through amount* that a *Distribution Network Service Provider* proposes in relation to a *distribution positive change event* under clause 6.7.3(c).

Distribution negative change event – For a *Distribution Network Service Provider*, a *distribution pass through event* which entails the *Distribution Network Service Provider* incurring materially lower costs in providing *direct control services* than it would have incurred but for that event.

Distribution negative pass through amount – In respect of a *distribution negative change event* for a *Distribution Network Service Provider*, an amount that is not greater than a *distribution required pass through amount* as determined by the *AER* under clause 6.7.3(g).

Distribution eligible pass through amount – In respect of a *distribution positive change event* for a *Distribution Network Service Provider*, the increase in costs in the provision of *direct control services* that the *Distribution Network Service Provider* has incurred and is likely to incur until the end of the *regulatory control period* as a result of that *distribution positive change event* (as opposed to the revenue impact of that event).

Distribution approved pass through amount – In respect of a *distribution positive change event* for a *Distribution Network Service Provider*:

(a) the amount which the *AER* determines should be passed through to *Distribution Network Users* under clause 6.7.3(d)(2); or

(b) the amount which the *AER* is taken to have determined under clause 6.7.3(e)(1), as the case may be.

Distribution required pass through amount – In respect of a *distribution negative change event* for a *Distribution Network Service Provider*, the costs in the provision of *direct control services* that the *Distribution Network Service Provider* has saved and is likely to save until the end of the *regulatory control period* as a result of that *distribution negative change event* (as opposed to the revenue impact of that event).

Distribution access charge – An amount described in rule 5.5(f) and 5.5(h)

Distribution capital expenditure criteria – Each of the matters listed in clause 6.6.7(c)(1)-(3).

Distribution capital expenditure factors – Each of the factors listed in clause 6.6.7(e)(1)-(9)

Distribution capital expenditure objectives – The objective set out in clause 6.6.7(a).

commercial arbitrator [note that the distribution Rules will not use commercial arbitrator in the same way as used in the AEMC draft transmission Rule proposal and this term is not needed for distribution]

Distribution Cost Allocation Guidelines – The guidelines referred to in clause 6.19.3

Distribution Cost Allocation Methodology For a *Distribution Network Service Provider*, the Cost Allocation Methodology approved by the *AER* for that *Distribution Network Service Provider* under clause 6.19.4(c) and (d) as amended from time to time in accordance with clauses 6.19.4(f) and (g).

Distribution Cost Allocation Principles – The principles set out in clause 6.19.2.

Distribution efficiency benefit sharing scheme – A scheme developed and published by the *AER* in accordance with clause 6.6.5"

Distribution efficiency benefit sharing scheme parameters – For an *efficiency benefit sharing scheme*, those parameters that are *published* by the *AER* in respect of that scheme pursuant to clauses 6.6.5(d)

Distribution indexed amount – "As at any time and in relation to a dollar value that is expressly set out in Part C of Chapter 6, that dollar value multiplied by CPI_a/CPI_b where:

CPI_a is the *CPI* as at that time; and

CPI_b is the Consumer Price Index: All Groups Index Number, weighted average of eight capital cities published by the Australian Bureau of Statistics for the quarter ending 30 June 2006.

Distribution negotiating framework - For a *Distribution Network Service Provider*, the negotiating framework approved or included by the *AER* for that *Distribution Network Service Provider* in a final decision under clause 6.14.1(7).

Distribution operating expenditure criteria – Each of the matters listed in clause 6.6.6(c)(1)-(3)

Distribution operating expenditure factors – Each of the factors listed in clause 6.6.6(e)(1)-(9)

Distribution operating expenditure objectives – The objectives set out in clause 6.6.6(a).

Distribution performance incentive scheme parameters – For a *service target performance incentive scheme*, those parameters that are *published* by the *AER* in respect of that scheme pursuant to clause 6.7.4(c)

Distribution service target performance incentive scheme – A scheme developed and *published* by the *AER* in accordance with clause 6.7.4.

Distribution post-tax revenue model – The model used to prepare the *Distribution Revenue Proposal* in accordance with Rule 6.5

Distribution roll forward model – The model developed and published by the *AER* for the roll forward of the regulatory asset base for *distribution system* in accordance with clause 6.6.1.

Distribution terms and conditions of access – The terms and conditions described in clause 6.1.4.

Distribution Weighted Average Cost of Capital - For a *Distribution Network Service Provider* for a *regulatory control period*, the return on capital for that *Distribution Network Service Provider* for that *regulatory control period* as calculated in accordance with clauses clause 6.6.2.

- **The definitions of the following terms (used in the Chapter 6A transmission Rule) will need to be changed to reflect changes to Chapter 6.**

publish/publication – (a) In the case of an invitation or notice referred to in clauses 6A.11.3(a)(5),

6A.12.2(a)(3) and (4), 6A.20(b)(3), 6.11.3(a)(5), 6.12.2(a)(3) and (4) or 6.20(b)(3), publish on the *AER's* website or the *AEMC's* website, as the case requires, and in a newspaper circulating generally throughout Australia.

(b) In the case of a notice referred to in clauses 6A.12.2(a)(2), 6A.13.3,

6A.20(e)(2), 6.12.2(a)(2), 6.13.3 or 6.20(e)(2), publish on the *AER's* website or the *AEMC's* website, as the case requires, in the *South Australian Gazette* and in a newspaper circulating generally throughout Australia.

(c) Where referred to in any other provision of Chapter 6A (other than Part I) or Chapter 6 (other than Part I), publish on the *AER's* website and make a copy available at the offices of the *AER*.

(d) In any other case, make available to *Registered Participants* electronically.

regulatory control period – (a) In respect of a *Transmission Network Service Provider*, a period of not less than 5 *regulatory years* in which a *total revenue cap* applies to that provider by virtue of a *revenue determination*.

(b) In respect of a *Distribution Network Service Provider*, a period of no less than 5 *regulatory years* in which a *regulatory cap* applies to that provider by virtue of a *distribution determination*.

relevant tax – Any tax payable by a *Transmission Network Service Provider* or a *Distribution Network Service Provider* other than:

(a) income tax and capital gains tax;

(b) stamp duty, financial institutions duty and bank accounts debits tax;

(c) penalties, charges, fees and interest on late payments, or deficiencies in payments, relating to any tax; or

(d) any tax that replaces or is the equivalent of or similar to any of the taxes referred to in paragraphs (a) to (c) (including any State equivalent tax).

- **The definitions of the following terms will need to be changed in Chapter 10 of the National Electricity Rules to reflect changes in Chapter 6.**

excluded distribution services (This term will not be used in new Chapter 6 and may be deleted)

prescribed distribution services (This term will not be used in new Chapter 6 and may be deleted)

price cap – this term is no longer used.

revenue cap – this term is no longer used. The AEMC has used "total revenue cap" for transmission.

regulatory cap – need to be changed in line with 6.2.5(b). Needs to stay given reference to regulatory cap in definition of regulatory control period.

negotiable service – (b) needs to be amended as follows "in relation to *distribution services* means *negotiated transmission services*"

Distribution Ring-Fencing Guidelines – "Has the meaning given in rule 6.21".

network coupling point – refers to schedule 6.3 (categories of distribution system costs)