



Australian Energy Market Commission

## CONSULTATION PAPER

National Electricity Amendment (Rate of Return Guidelines Review) Rule 2016

National Gas Amendment (Rate of Return Guidelines Review) Rule 2016

**Rule proponent**

Australian Energy Regulator

18 August 2016

RULE  
CHANGE

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AEMC, Rate of Return Guidelines Review, Consultation Paper, 18 August 2016, Sydney

**About the AEMC**

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

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# 1 Introduction

On 7 June 2016, the Australian Energy Regulator (AER) submitted a rule change request to the Australian Energy Market Commission (AEMC or Commission) seeking to extend the deadline to review the current Rate of Return Guidelines (the Guideline).<sup>1</sup> The Guideline was first published on 17 December 2013, and the proposed rule change would extend the deadline of the first review from 17 December 2016 to 17 December 2018.

This paper has been prepared to facilitate public consultation on the rule change request and to seek stakeholder submissions. The paper:

- provides a summary of, and background to, the rule change request;
- identifies a number of questions and issues to facilitate consultation on the rule change request; and
- outlines the process for making submissions.

## 1.1 Background

The Guideline is a document published by the AER. It provides information specifying the approach that the AER proposes to use in determining the allowed rate of return as part of the regulatory determination and access arrangement decision processes for electricity network and gas transmission and distribution pipeline service providers (service providers). The Guideline plays an integral role in the regulatory decision making processes.

The Guideline contains information about how the AER proposes to estimate the allowed rate of return, including how its methodologies will result in determinations that are consistent with the allowed rate of return objective.<sup>2</sup> The Guideline must include the estimation methods, financial models, market data and other evidence the AER proposes to take into account when determining the return on equity, return on debt, and the value of imputation credits.

The AEMC's 2012 Economic Regulation of Network Service Providers Rule established the Guideline and its application to both gas and electricity service providers. Amendments made to Chapter 6 and 6A of the NER and rule 87 of the NGR under that rule required the AER to periodically publish the Guideline and to consult with stakeholders on its contents in doing so. The AER is required to review the Guideline at intervals of no greater than three years.<sup>3</sup>

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<sup>1</sup> Clauses 6.5.2(m) and 6A.6.2(m) of the National Electricity Rules (NER) and rule 87(13) of the National Gas Rules (NGR) require the AER to make and publish the Rate of Return Guidelines.

<sup>2</sup> Clauses 6.5.2(c) and 6A.6.2(c) of the NER and rule 87(3) of the NGR specifies that the allowed rate of return objective is that the rate of return for a service provider is to be commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk as that which applies to the service provider in respect of the provision of standard control services (in the case of the NER) and reference services (in the case of the NGR).

<sup>3</sup> This is set out in clauses 6.5.2(p)(1) and 6A.6.2(p)(1) of the NER and rule 87(16)(a) of the NGR.

The Guideline is not binding and service providers and the AER may depart from the Guideline, subject to providing reasons for such departure.<sup>4</sup>

The AER is also able to amend or replace the Guideline at any time provided all requirements for consultation are met<sup>5</sup> and that it is reviewed at intervals not exceeding three years. This allows the AER to account for changing circumstances with respect to the external environment and in relation to information that affects how the allowable rate of return should be determined. It also provides the AER some flexibility to determine a suitable revision schedule that can accommodate the business needs of the service providers in the regulatory determination and access arrangement processes.

The initial publication date of the Guideline was 17 December 2013. Accordingly, the first review of the Guideline is required to be undertaken by no later than 17 December 2016.

## **1.2 Issues raised in the rule change request**

The AER stated in its rule change request that key elements of the current Guideline are in contention before the Australian Competition Tribunal and Federal Court of Australia and that a final resolution of these proceedings is unlikely to occur before 17 December 2016. Accordingly, the AER considers that there is 'no value' in commencing a review of the Guideline before the Tribunal and Federal Court proceedings are complete as the outcomes of these proceedings will likely result in a change of approach as to how the allowed rate of return is determined.<sup>6</sup>

The AER noted that the proposed timing of the revised Guideline (17 December 2018) is likely to occur during a period where some service providers would be in the midst of their regulatory determination or access arrangement processes.

## **1.3 Proposed solution**

This section outlines the AER's proposed solution to the issues noted above. It also sets out the additional changes that the AEMC considers may be necessary to improve clarity for stakeholders about additional timing related issues arising from the AER's proposed solution.

### **1.3.1 Guideline review deadline extension**

The AER has sought to extend the review deadline of the next Guideline from 17 December 2016 to 17 December 2018. This requires amending the NER and NGR to extend the first (initial) review period from the current three years, to five years. It is proposed that subsequent reviews of the Guideline would continue on the existing three year cycle. The proposed deadline anticipates that the Australian Competition Tribunal and Federal Court of Australia proceedings would have concluded, and that

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<sup>4</sup> The flexibility for the AER to depart from the Guideline is set out in clauses 6.2.8(c) and s. 6A.2.3(c) of the NER and rule 87(18) of the NGR. The flexibility for service providers to depart from the Guideline is set out in Schedules 6.1.3(9) and S6A.1.3 of NER and rule 72(1)(g) of NGR.

<sup>5</sup> This is set out in clauses 6.2.8(e) and 6A.2.3(e) of the NER and rule 87(17) of the NGR.

<sup>6</sup> AER, Request for a rule change, 7 June 2016, p. 2.

the AER would then have sufficient time to develop, consult and publish a revised Guideline.

The AER stated that the rule change request meets the national electricity objective (NEO) and the national gas objective (NGO) because the proposed rule would allow the AER to fully consider the outcome of proceedings of the Tribunal and the Federal Court prior to revising the Guideline. In its view, this will improve the predictability of outcomes relating to rate of return issues. The AER considered that this is likely to materially benefit the long term interest of consumers. The AER also proposed that the rule change request be treated as non-controversial on the basis that the 'proposed rule change is unlikely to have a significant effect on the energy market.'<sup>7</sup>

The AER also proposed to develop a structure and schedule to consider the application of the revised Guideline on any of its regulatory decision making processes that are underway at the time the revised Guideline is published. It also stated that all stakeholders would have reasonable opportunity to discuss how the Guideline may impact on such decision making processes.

<b>Question 1</b>	<b>Proposed solution</b>
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<b>The AEMC seeks stakeholder views on any potential benefits, costs and risks that the proposed solution carries.</b>
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### 1.3.2 Timing issue and potential transitional provisions

The AEMC notes that the proposed Guideline review deadline (17 December 2018) may be problematic for six service providers (TasNetworks, Power and Water, Ausgrid, Endeavour, Essential, and ActewAGL – the affected service providers). The AER's regulatory determination forward schedule<sup>8</sup> indicates that the earliest an affected service provider could submit a revised regulatory proposal is 30 November 2018.<sup>9</sup> This means that the revised Guideline is likely to be published near the time that revised proposals are due. Given that these two dates are flexible, scenarios may arise where the revised Guideline is published before an affected service provider has submitted its revised regulatory proposal.

The AEMC understands that certain stakeholders have concerns regarding this timing as it is unclear if the current 2013 Guideline, or the revised Guideline should apply to their revised regulatory proposal. If the revised Guideline were to apply, the affected service providers would be unlikely to have had sufficient time to consider it and

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<sup>7</sup> AER, Request for a rule change, 7 June 2016, p. 1.

<sup>8</sup> Attachment A is based on the 'AER 7 year regulatory determination calendar 2015-2022' (June 2016 version) found at: <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements>, accessed on 2 August 2016. This attachment superimposes the current (yellow) and proposed (green) Guideline review deadline dates. The gas service provider schedule has not been included as there are no conflicts with gas service providers at the proposed review deadline.

<sup>9</sup> The AER's forward schedule provides indicates that it will release its draft determinations for the affected service providers on 31 September 2018. Service providers must wait at least 45 business days before submitting a revised regulatory proposal. Therefore, the earliest that affected service providers can submit their revised regulatory proposals is 30 November 2018.

decide on whether and how to either incorporate or depart from the Guideline in their regulatory proposals.

In order to address this timing issue, the AEMC considers that transitional arrangements may be required accompany the AER's proposed amendments to the NER and NGR. The purpose of such transitional provisions would be to promote regulatory certainty to the affected service providers and other stakeholders by specifying these arrangements from the outset.

The AEMC's initial view is that if transitional provisions are necessary, the most appropriate approach would be for the provisions to specify that the current 2013 Guideline would apply to the 2018 regulatory determination processes of the affected service providers rather than the revised Guideline published following the review process. Additionally, such provisions would only apply in respect of the first review of the Guideline and would not prevent affected service providers, or the AER, from being able to depart from the 2013 Guideline.<sup>10</sup>

The AEMC considered a range of alternative measures to address the timing issue generated by the proposed Guideline review deadline. However, our initial view is that these alternative measures are unlikely to be as effective as the approach above.

For instance, the AEMC considered the potential benefits of moving the date of the proposed first review deadline forward in order to allow those affected service providers more time to consider information contained within the new Guideline. This, however, would reduce the already very limited time that the AER has to develop, consult and publish the Guideline following the anticipated conclusion of the Tribunal and Federal Court proceedings.

The AEMC also considered the potential impact of moving the date of the proposed first review deadline further into the future by several months in order to remove any confusion about what Guideline should apply to the affected service providers. However, this would result in the same timing issue being replicated for other service providers in the midst of their regulatory determination or access arrangement processes. Accordingly, this would only delay the issue, and transfer it from one group of service providers to another.

The third potential transitional arrangement considered by the AEMC was to require that the version of the Guideline that has been published three to six months before an affected service provider's first regulatory proposal submission date, is to be the Guideline that would apply to that process. However, this approach would mean that either the AER would have to complete the review process earlier, or the guideline would not apply to a significant number of service providers.

The rule change request has been submitted on an expedited basis as a non-controversial rule change.<sup>11</sup> Should the rule change request proceed on an expedited basis, there would be no draft rule determination to consult on a draft rule, including draft transitional provisions.

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<sup>10</sup> Those parties that wish to depart from the relevant Guideline would still be able to do so, subject to providing reasons for such departure.

<sup>11</sup> See section 2 of this consultation paper for further details regarding the expedited rule making process.

## Question 2 Transitional provisions

The AEMC seeks stakeholder comment on these timing issues, including:

1. whether the timing issue is a significant issue for affected stakeholders and why; and
2. whether the proposed transitional provisions would be likely to address the issue.

### 1.4 Assessment framework

The AEMC's assessment of this rule change request must consider whether the proposed rule promotes the NEO as set out under s. 7 of the NEL and the NGO as set out in s. 23 of the National Gas Law.

The NEO states:

“That the object of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, safety, reliability and security of supply of electricity; and the reliability, safety and security of the national electricity system.”

The NGO states:

“The objective of this Law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.”

In considering this rule change request, the AEMC will assess it against the NEO and NGO. In particular, it proposes to consider whether the proposed rule is likely to promote efficient investment in electricity and gas services for the long term interests of consumers. The AEMC considers this aspect of the NEO and NGO to be most relevant as the rule change request seeks to provide for the Guideline to include the most current and relevant information available. Importantly, this is to allow for the outcomes of the Australian Competition Tribunal and Federal Court of Australia proceedings to be taken into account in the review process. Including relevant, up-to-date information in the Guideline has the potential to reduce regulatory costs, and lower the risk of (and costs associated with) reviews of future regulatory determinations and decisions. Costs that are avoided would therefore not be passed onto consumers.

In carrying out an assessment of the rule change request against the NEO and NGO, the AEMC will consider the following principles:

- **Transparency of information:** clear, accountable and relevant information is provided to stakeholders in order to support the efficient investment in electricity and gas services.
- **Benefits and costs:** the benefits of extending the Guideline review deadline should be greater than the counterfactual, and the costs of extending the Guideline review deadline should be less than the counterfactual.

#### **1.4.1 Application in the Northern Territory and Western Australia**

In July 2016, the AEMC assumed rule making responsibility for parts of the NER in the Northern Territory. This is the first rule change request that will, if made, apply to the Northern Territory.

The National Electricity (Northern Territory) (National Uniform Legislation) Act 2015 allows for an expanded definition of the national electricity system in the context of the application of the NEO to rules made in respect of the Northern Territory, as well as providing the AEMC with the ability to make a differential rule that varies in its terms between the national electricity system and the Northern Territory's local electricity system. The AEMC will consider whether a differential rule is required for the Northern Territory electricity service providers.

If made, the proposed rule would also apply to gas pipeline service providers in both the Northern Territory and Western Australia.

## 2 Process for this rule change

### 2.1 Treatment as a non-controversial rule change

The AER proposed that the rule change request be treated as non-controversial in accordance with s. 96 of the NEL and s. 304 of the NGL such that it could be processed on an expedited basis, and a rule made (or not made) in advance of the proposed 17 December 2016 review deadline.

The AER considers that the rule change request is a request for a non-controversial rule on the basis that it is 'unlikely to have a significant impact on the national energy market.'<sup>12</sup> The AER stated that 'conducting a guidelines review at any point in time is likely to impact on one or more of the AER's regulatory determination processes' and considered that it would not 'at an overall level, exacerbate these impacts relative to current arrangements.'<sup>13</sup>

The AER also provided two letters from stakeholders, (the Energy Networks Association and Public Interest Advocacy Centre) expressing support for the rule to be considered on a non-controversial basis. Certain stakeholders have also informally indicated to the AEMC support for the proposed rule to be considered on a non-controversial basis.

The AEMC considers that the rule change request should be subject to the expedited rule making process under s. 96 of the NEL and s. 304 of the NGL on the grounds that it considers the rule change request to be non-controversial.<sup>14</sup> The AEMC considers that the rule change is unlikely to have a significant impact on the National Electricity Market (NEM), gas market or the regulation of pipeline services. This is because the impact of the proposed rule would not be materially different to current arrangements, because if made, the proposed rule would:

- require the 2013 Guideline to remain in force for all service providers' regulatory proposals until a revised Guideline is reviewed by 17 December 2018;
- not prevent service providers, or the AER, from being able to depart from the 2013 Guideline; and
- not impose additional costs on service providers.

Rule changes that are considered to be non-controversial may be processed under an expedited (faster) process under which there is only one round of consultation and the AEMC must publish its final rule determination within six weeks of commencing the rule change process.<sup>15</sup>

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<sup>12</sup> AER, Request for a rule change, 7 June 2016, p. 1.

<sup>13</sup> AER, Request for a rule change, 7 June 2016, p. 4.

<sup>14</sup> s. 87 of the NEL defines a 'non-controversial rule' as 'a rule that is unlikely to have a significant effect on the national electricity market'. s. 290 of NGL defines 'non-controversial rule' as 'a rule that is unlikely to have a significant effect on a market for gas or the regulation of pipeline services'.

<sup>15</sup> The AEMC has published a notice under ss. 95 and 96 of the National Electricity Law and ss. 303 and 304 of the National Gas Law to commence and assess this rule change request as a non-controversial rule.

The AEMC has decided to use an expedited process to consider this rule change request, provided that it does not receive any valid requests not to use the expedited process by 1 September 2016. To be valid, an objection to the expedited process should set out the reasons why the rule change request will have a significant impact on the national electricity market and the market for gas or the regulation of pipeline services.

While the rule change is considered appropriate for an expedited process, it warrants an extension of the time between the publication of the consultation paper and the final determination from six weeks to eight weeks. The extension allows more time to consider submissions to the consultation paper, in particular in relation to the timing issues raised in section 1.3.2.

## **2.2 Key dates**

Given the tightly defined nature of the issue, and the background information provided in the rule change request, this consultation paper is brief. Nevertheless, submissions are invited in relation to the matters identified above, and any other relevant issue.

The **key dates** for stakeholders in this process are as follows:

- Commencement of this rule change process: 18 August 2016
- Objections to an expedited process to be received by: 1 September 2016
- Submissions to the proposal to be received by: 15 September 2016
- Final decision to be published under an expedited process by: 13 October 2016

### **3 How to lodge a submission**

The Commission invites requests not to make a rule under the expedited process and written submissions on this rule change proposal.

The rule change request can be found on the AEMC website, [www.aemc.gov.au](http://www.aemc.gov.au).

All enquiries on this project should be addressed to Julian La Brooy on (02) 8296 7844.

#### **3.1 Lodging a request not to make a rule under an expedited process**

Written requests not to make a rule under the expedited process in s. 96 of the National Electricity Law and s. 304 of the National Gas Law must include reasons for the request, and must be lodged with the Commission by 1 September 2016, either online or by mail, in accordance with the requirements specified below.

#### **3.2 Lodging a submission to this rule change request**

Written submissions on the rule change request must be lodged with Commission by 15 September 2016, either online or by mail, in accordance with the requirements specified below.

Where practicable, submissions should be prepared in accordance with the Commission's guidelines for making written submissions on rule change requests.<sup>16</sup> Please note that the Commission publishes all submissions on its website, subject to a claim of confidentiality.

#### **3.3 Lodging a submission electronically**

Electronic submissions, or requests not to make a rule under the expedited process, must be lodged online via the Commission's website, [www.aemc.gov.au](http://www.aemc.gov.au), using the "lodge a submission" function and selecting the project reference code: ERC0207.

The request or submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

Upon receipt of the electronic request or submission, the Commission will issue a confirmation email. If this confirmation email is not received within three business days, it is the submitter's responsibility to ensure the request or submission has been delivered successfully.

#### **3.4 Lodging a submission by mail or fax**

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated. The request or submission should be sent by mail to:

Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

The envelope must be clearly marked with the project reference code: ERC0207.

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<sup>16</sup> This guideline is available on the Commission's website.

Alternatively, the submission may be sent by fax to (02) 8296 7899.

Except in circumstances where the submission has been received electronically, upon receipt of the hardcopy submission the Commission will issue a confirmation letter.

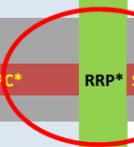
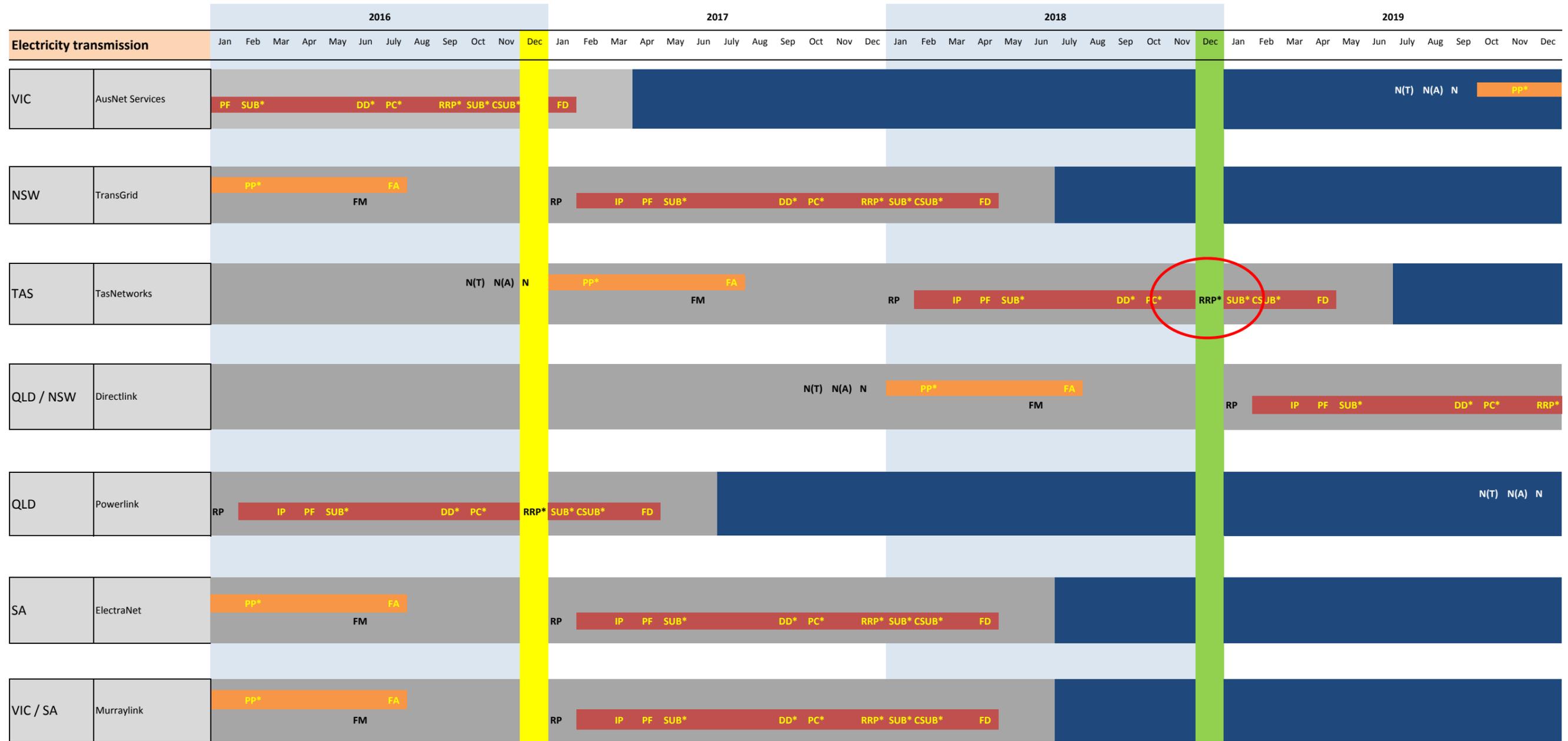
If this confirmation letter is not received within 3 business days, it is the submitter's responsibility to ensure successful delivery of the submission has occurred.

## Abbreviations

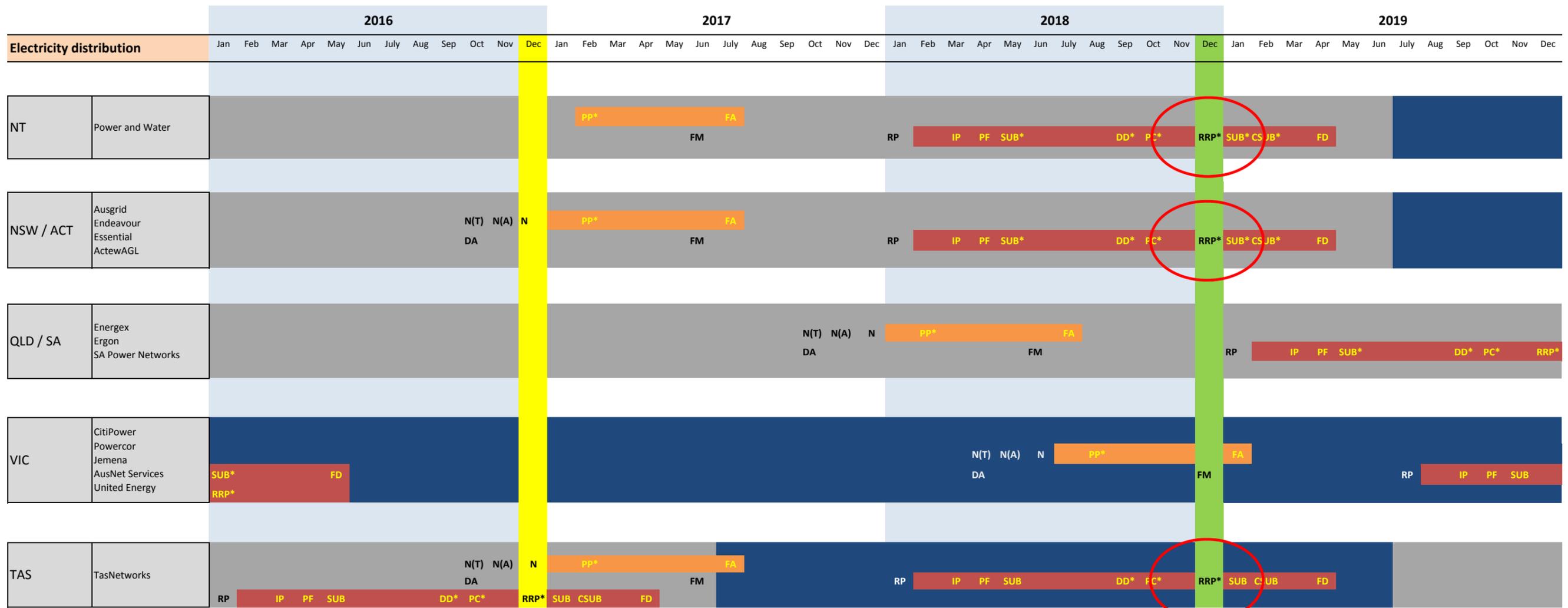
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
affected service providers	TasNetworks, NT Power and Water, Ausgrid, Endeavour, Essential, and ActewAGL
Commission	See AEMC
Guideline	The Rate of Return Guidelines
NEL	National Electricity Law
NEM	National Electricity Market
NEO	national electricity objective
NGO	national gas objective
service providers	Electricity network and gas transmission and distribution pipeline service providers

# Attachment A

## AER 7 year project calendar 2015-22: Regulatory determinations



## AER 7 year project calendar 2015-22: Regulatory determinations



### Legend

**\* Indicative only**

- Current regulatory control/access arrangement period (remaining years)
- Upcoming regulatory control/access arrangement period
- Transitional year (for gas)
- Framework and approach process
- Regulatory determination process
- Current Rate of Return Guideline due to be reviewed
- Proposed Rate of Return Guidelines review deadline

**Framework and approach**

- N(T)** NSP notifies AER on need for framework & approach stage
- N(A)** AER consults on need for framework & approach for component not triggered by NSP
- N** AER issues notice on need for framework & approach stage
- PP** Position paper on framework & approach
- FA** Final framework and approach paper released by the AER
- DA** DNSP notifies AER on the value of dual function assets

**Revenue proposal**

- FM** NSP notifies the AER of its proposed methodology for forecasting expenditures
- RP** Regulatory proposal due end of month
- IP** AER publish issues paper on regulatory proposal
- PF** AER hold public forum on issues paper and regulatory proposal
- SUB** Submissions close on regulatory proposal & issues paper

**Draft decision**

- DD** Draft determination released by the AER
- PC** Predetermination conference on draft determination

**Final decision**

- RRP** Revised regulatory proposal due
- SUB** Submission on draft determination and revised proposal close
- CSUB** Cross- submissions close
- FD** Final determination released by the AER