



# RULE CHANGE

Australian Energy Market Commission

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## **RULE DETERMINATION**

National Electricity Amendment (Payments under Feed-in Schemes and Climate Change Funds) Rule 2010

**Rule Proponent**

ETSA Utilities

**Commissioners**

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1 July 2010

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**About the AEMC**

The Council of Australian Governments, through its Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005 to be the rule maker for national energy markets. The AEMC is currently responsible for rules and providing advice to the MCE on matters relevant to the national energy markets. We are an independent, national body. Our key responsibilities are to consider rule change proposals, conduct energy market reviews and provide policy advice to the MCE, as requested, or on AEMC initiative.

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## Summary

The Australian Energy Market Commission (AEMC or Commission) has determined to make a Rule that provides a cost recovery mechanism for distribution network service providers (DNSPs) for payments they make under feed-in tariff schemes and climate change funds. The Commission did not assess the merits or efficiency of these jurisdictional schemes themselves, as the schemes have been established by jurisdictional governments and are not within the scope of the Commission's powers. The Commission's considerations were limited to the operation of the new cost recovery mechanism, and related processes, in respect of the recovery of payments under these jurisdictional schemes under the Rules.

A number of jurisdictions currently have in place feed-in schemes where payments are made (or credits given) by DNSPs to certain parties for electricity that distributed generation installations generate or "feed back" into the distribution network. New South Wales also has in place a Climate Change Fund, which is a government fund that may be used to provide funding to assist with various environmental initiatives or to fund contributions by NSW for the purpose of national energy regulation.

The National Electricity Rules (NER or Rules) did not include an explicit mechanism for DNSPs to recover payments made under these schemes. The Rule as Made, which is a more preferable Rule, provides an explicit cost recovery mechanism under the pricing provisions in Chapter 6 of the Rules. The Rule as Made also includes transitional provisions to allow DNSPs to utilise the new cost recovery mechanism in their current regulatory control periods.<sup>1</sup>

In making this determination, the Commission took into account impacts of the Rule as Made on promoting the efficient operation of electricity services. The Commission considers the Rule as Made reduces the administrative burden faced by DNSPs and the Australian Energy Regulator (AER) and contributes to the efficiency and accuracy of payment forecasts.

This Rule determination and the Rule as Made are largely reflective of, and consistent with, the draft Rule determination and the draft Rule. The Commission has made changes to the Rule as Made to clarify the application of the new cost recovery provisions. If any existing, or subsequently approved, jurisdictional schemes were to be amended in the future, a DNSP would be required to set out in its next pricing proposal how the amended schemes meet the eligibility criteria for jurisdictional schemes. In addition, the Rule as Made provides for the adjustment of any over/under recovery of jurisdictional scheme amounts to be carried out more accurately. Other minor clarifications have also been made.

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<sup>1</sup> It is noted that there are provisions under the transitional Chapter 6 provisions in Chapter 11 of the Rules to allow NSW DNSPs to recover payments made to the NSW Climate Change Fund.

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# 1 ETSA Utilities' Rule change request

## 1.1 The Rule change request

On 7 October 2009, ETSA Utilities (Rule Proponent) made a request to the Australian Energy Market Commission (AEMC or Commission) to make a Rule regarding the way in which distribution network service providers (DNSPs) may recover payments they make under feed-in tariff schemes and climate change funds (Rule Change Request). The Rule Change Request included proposed amendments to Chapter 6 of the National Electricity Rules (NER or Rules).

## 1.2 Rule change request rationale

A number of jurisdictions have introduced feed-in schemes where payments are made (or credits given) by DNSPs to eligible parties, such as owners of distributed renewable generation installations, for the electricity distributed generation installations generate or "feed back" into the distribution network. New South Wales (NSW) also has in place a Climate Change Fund, which is a fund that can be used to provide funding to assist with various environmental initiatives or to fund contributions by NSW for the purpose of national energy regulation.

Although the details of the feed-in schemes and the climate change funds vary, these schemes require DNSPs to make payments or give credits to eligible parties. The Rule Change Request stated that "DNSPs are both the ultimate vehicle through which payments are made to customers for the gross or net energy they produce or to the fund for climate change abatement initiatives and, by levying incremental charges, the means by which these payments can be recovered from the general population of customers".<sup>2</sup>

Currently there is no explicit mechanism under the Rules for DNSPs to recover payments they make (or, in the case of credits being provided, revenue foregone) under feed-in schemes and climate change funds.<sup>3</sup> To date, the recovery of the payments made under feed-in schemes has been addressed through DNSPs forecasting the payments as a component of operating expenditure in their regulatory proposals. Subject to a materiality threshold, any over/under recovery of the payments would be adjusted under the provisions for a pass through event.<sup>4</sup> The proposed Rule change

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<sup>2</sup> ETSA Utilities' Rule Change Request, p. 1.

<sup>3</sup> It is noted that a Climate Change Fund is in place in NSW and provisions under the transitional Chapter 6 of the Rules provide a mechanism for the recovery of contributions made to this fund by DNSPs in the 2009-2014 regulatory control period. Specific requirements for NSW with respect to this Rule Change Request is discussed further in chapter 8 of this determination.

<sup>4</sup> That is, the pass through provisions under clause 6.6.1 of the Rules would be used. This process has been adopted in the 2009-2010 to 2013-2014 distribution determination for ActewAGL for the recovery of payments that ActewAGL makes under the ACT feed-in scheme. The draft distribution determination for ETSA Utilities, Ergon and Energex has adopted similar provisions for the next regulatory control period for these DNSPs.

would introduce an explicit mechanism for the recovery of the payments under feed-in schemes and climate change funds under the pricing provisions in Chapter 6 of the Rules.

### **1.3 Solution proposed by the Rule Change Request**

In the Rule Change Request the Rule Proponent sought to add an explicit provision in the Rules to allow DNSPs to recover payments they make under feed-in schemes and climate change funds. The Rule Change Request proposed to:

- add provisions to Chapter 6 of the Rules to set out a new mechanism for the recovery of payments under feed-in schemes and climate change funds under the pricing provisions (outside of the distribution determination process). This new mechanism would provide that a DNSP's pricing proposal would set out the recovery of tariffs designed to be passed on to customers and adjustments of any over/under recovery from the previous regulatory year; and
- make consequential amendments to a number of other clauses in Chapter 6 and Chapter 10 of the Rules.

### **1.4 Commencement of Rule making process**

On 14 January 2010, the Commission published a notice under section 95 of the National Electricity Law (NEL) advising of its intention to commence the Rule making process and the first round of consultation in respect of the Rule Change Request. A consultation paper prepared by AEMC staff identifying specific issues or questions for consultation was also published with the Rule Change Request. Submissions closed on 12 February 2010.

The Commission received nine submissions on the Rule Change Request as part of the first round of consultation. The submissions are available on the AEMC website.<sup>5</sup> A summary of the issues raised in submissions and the Commission's response to each issue is contained in Appendix A.1.

### **1.5 Publication of draft Rule determination and draft Rule**

On 8 April 2010 the Commission published a notice under section 99 of the NEL and a draft Rule determination in relation to the Rule Change Request (Draft Rule Determination). The Draft Rule Determination included a draft Rule (Draft Rule).

Submissions on the Draft Rule Determination and Draft Rule closed on 21 May 2010. The Commission received seven submissions. The submissions are available on the AEMC website. A summary of the issues raised in submissions, and the Commission's response to each issue, is contained in Appendix A.2.

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5 [www.aemc.gov.au](http://www.aemc.gov.au)



## 2 Final Rule Determination

### 2.1 Commission's determination

In accordance with section 102 of the NEL, the Commission has made this final Rule determination in relation to the Rule proposed by ETSA Utilities. In accordance with section 103 of the NEL the Commission has determined not to make the Rule proposed by the Rule proponent and to make a more preferable Rule.<sup>6</sup>

The Commission's reasons for making this final Rule determination are set out in section 3.1

The *National Electricity Amendment (Payments under Feed-in Schemes and Climate Change Funds) Rule No. 7 2010* (Rule as Made) is published with this final Rule determination. The Rule as Made commences on 1 July 2010. The Rule as Made is a more preferable Rule and its key features are described in section 3.2.

### 2.2 Commission's considerations

In assessing the Rule Change Request the Commission has considered the following matters:

- the Commission's powers under the NEL to make the Rule;
- the Rule Change Request;
- the fact that there is no relevant Ministerial Council on Energy (MCE) Statement of Policy Principles in relation to this Rule Change Request;<sup>7</sup>
- submissions received during first and second rounds of consultation; and
- the Commission's analysis as to the ways in which the proposed Rule will, or is likely to, contribute to the National Electricity Objective (NEO).

The Commission has not considered the merits or efficiency of the jurisdictional schemes as the schemes have been established by jurisdictional governments and are not within the scope of the Commission's powers. The Commission's considerations were limited to the operation of the new cost recovery mechanism, and related processes, in respect of the recovery of payments under these jurisdictional schemes under the Rules.

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<sup>6</sup> Under section 91A of the NEL the AEMC may make a Rule that is different (including materially different) from a market initiated proposed Rule (a more preferable Rule) if the AEMC is satisfied that having regard to the issue or issues that were raised by the market initiated proposed Rule (to which the more preferable Rule relates), the more preferable Rule will or is likely to better contribute to the achievement of the NEO.

<sup>7</sup> Under section 33 of the NEL the AEMC must have regard to any relevant MCE Statement of Policy Principles in making a Rule.

## 2.3 Commission's power to make the Rule

The Commission is satisfied that the Rule as Made falls within the subject matter about which the Commission may make Rules. The Rule as Made falls within section 34(2) of the NEL which states that "...[the AEMC] may make Rules for or with respect to any matter or thing specified in Schedule 1" of the NEL. The Rule as Made falls within the matters set out in Schedule 1 to the NEL as it relates to the regulation of prices that are charged by DNSPs in their provision of distribution services.<sup>8</sup> That is, item 26 of Schedule 1 of the NEL states:

"The regulation of prices (including the tariffs and classes of tariffs) charged or that may be charged by owners, controllers or operators of distribution systems for the provision by them of services that are the subject of a distribution determination."

## 2.4 Rule making test

Under section 88(1) of the NEL the Commission may only make a Rule if it is satisfied that the Rule will, or is likely to, contribute to the achievement of the NEO. This is the decision making framework that the Commission must apply.

The NEO is set out in section 7 of the NEL as follows:

"The objective 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:

- (a) price, quality, safety, reliability and security of supply of electricity;  
and
- (b) the reliability, safety and security of the national electricity system."

For the Rule Change Request the Commission considers that the relevant aspect of the NEO is promoting the efficient operation of electricity services.<sup>9</sup>

The Commission is satisfied that the Rule as Made will, or is likely to, contribute to the achievement of the NEO because the Rule as Made promotes administrative efficiency and productive efficiency in the operation of electricity services. It also promotes the efficiency by which DNSPs carry out forecasts. Efficiency in the operation of electricity services would minimise the costs faced by DNSPs and the Australian Energy Regulator (AER), and hence should be in the long term interest of consumers with respect to the price of supply of electricity. The Rule as Made promotes efficiency in the following ways:

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<sup>8</sup> Some clauses in the Rule as Made also fall within matters set out in item 25 or item 26H of Schedule 1 to the NEL.

- Administrative efficiency - the Rule as Made contributes to administrative efficiency by providing a specific mechanism under the pricing provisions for the recovery of payments made by DNSPs under jurisdictional schemes. This new mechanism removes the requirement for the recovery of these payments to be addressed under the distribution determination and pass through processes, which reduces the administrative burden faced by DNSPs and the AER;
- Productive efficiency - the Rule as Made contributes to productive efficiency as it provides for payments made under any future eligible jurisdictional schemes to be recovered through the new cost recovery mechanism. This contributes to productive efficiency as, if the new mechanism did not apply to new schemes, DNSPs would be required to seek recovery under a pass through event which would likely require more resources from DNSPs and the AER to undertake applications and assessments; and
- Efficiency and accuracy of payment forecasts - the Rule as Made contributes to the efficiency by which DNSPs produce forecasts of payments that need to be made under jurisdictional schemes as the new cost recovery mechanism in the Rule as Made provides for annual adjustments for over/under recovery to be carried out more efficiently under the pricing process as opposed to a cost pass through process. In addition, the Rule as Made would require DNSPs to produce annual estimates of costs which would likely be more accurate than the five-year forecasts currently required. This improves the ability for DNSPs to recover any costs closer to the time they were actually incurred and increase the likelihood that costs are recovered from the customer base in relation to whom the costs were incurred.

Under section 91(8) of the NEL the Commission may only make a Rule that has effect with respect to an adoptive jurisdiction if it is satisfied that the proposed Rule is compatible with the proper performance of the Australian Energy Market Operator's (AEMO's) declared network functions. The Draft Rule is compatible with AEMO's declared network functions because it has no impact on Rules relating to AEMO's declared network functions or transmission network service providers in general.

## **2.5 More preferable Rule**

Under section 91A of the NEL, the AEMC may make a Rule that is different (including materially different) from a market initiated proposed Rule (a more preferable Rule) if the AEMC is satisfied that, having regard to the issue or issues that were raised by the market initiated proposed Rule (to which the more preferable Rule relates), the more preferable Rule will or is likely to better contribute to the achievement of the NEO.

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<sup>9</sup> Under section 88(2) of the NEL, for the purposes of section 88(1) the AEMC may give such weight to any aspect of the NEO as it considers appropriate in all the circumstances, having regard to any relevant MCE statement of policy principles.

Having regard to the issues raised by the Rule proposed in the Rule Change Request, the Commission is satisfied that the Rule as Made will, or is likely to, better contribute to the NEO for the following reasons:

- Clear transitional provisions - the Rule as Made sets out specific transitional provisions to allow the new cost recovery mechanism to be adopted in a timely manner, which would allow the potential efficiency gains to be realised sooner;
- Specific transitional provisions for NSW - the Rule as Made sets out specific transitional provisions for NSW and clarifies the existing provisions under the transitional Chapter 6, which ensures the potential efficiency gains under the Rule as Made would be available to all DNSPs equally;
- Applicable schemes - the Rule as Made more clearly sets out the applicable schemes and provides criteria which any future schemes would be required to meet, which provides transparency and ensures that DNSPs could utilise the new cost recovery mechanism for any eligible new schemes.

## **2.6 Other requirements under the NEL**

Under section 88B of the NEL, the AEMC must take into account the revenue and pricing principles in making a Rule for, or with respect to, any matter or thing specified in items 15 to 24 and 25 to 26J of Schedule 1 of the NEL. The Commission has taken into account the revenue and pricing principles in making this Rule determination as the Rule as Made relates to item 26 of Schedule 1 of the NEL. Some aspects of the revenue and pricing principles relate to providing a reasonable opportunity to service providers to recover efficient costs and ensuring that prices should allow for a return commensurate with the regulatory and commercial risks in providing the service. The Commission considers that the Rule as Made is consistent with the revenue and pricing principles as it provides an efficient and transparent mechanism for the recovery of payments that DNSPs, in their capacity as DNSPs, are obliged to make under legislation.

### 3 Commission's reasons

The Commission has analysed the Rule Change Request and assessed the issues/propositions arising out of this Rule Change Request. For the reasons set out below, the Commission has determined that a more preferable Rule should be made.

#### 3.1 Assessment

The Commission considers that DNSPs should be provided with reasonable opportunity to recover any payments mandated by legislation where no other recovery mechanism is applicable outside the Rules.<sup>10</sup> The feed-in schemes and the NSW Climate Change Fund currently in place impose obligations on DNSPs to make payments (or apply credits) to certain parties or into a government fund. As these obligations are imposed on the DNSPs in their capacity as DNSPs, the DNSPs should be provided with an opportunity to recover these payments under the Rules as part of their costs of providing distribution network services.

Currently, there are no explicit mechanisms under the Rules for the recovery of these types of payments.<sup>11</sup> Recovery of payments made under feed-in schemes have, to date, been addressed as operating expenditure through the distribution determination process with the pass through mechanism used to adjust any over/under recovery. However, the distribution determination process and the pass through mechanism were not designed to address the recovery of payments made by DNSPs under jurisdictional schemes such as feed-in schemes. To provide a solution to address the problems under the current approach for the recovery of these payments, a Rule would be required to introduce a more appropriate cost recovery mechanism for the recovery of payments that DNSPs are required to make, in their capacity as DNSPs, under legislation where:

- there are no means of recovering the payments;<sup>12</sup> and
- the payment amounts are specified or determined in accordance with legislation.

#### 3.2 Rule as Made

The Rule as Made provides a new cost recovery mechanism for the recovery of payments made (or revenue foregone in the case of credits applied) by DNSPs under jurisdictional schemes (such as feed-in schemes and climate change funds). The Rule as Made has the features as set out below.

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<sup>10</sup> The Commission notes that the ability to recover the payments would not apply to any payments in the nature of fines, penalties or incentives for DNSPs.

<sup>11</sup> It is noted that the transitional Chapter 6 that applies to NSW and the ACT for the 2009-2014 regulatory control period includes provisions for the recovery of payments made to the NSW Climate Change Fund.

<sup>12</sup> As noted above, the recovery would exclude payments in the nature of fines, penalties or incentives.

- (i) The Rule as Made provides a new cost recovery mechanism under the pricing proposal process, which includes a provision to allow any over/under recovery during the previous two regulatory years to be adjusted.
- The new cost recovery mechanism allows each DNSP to outline its forecast recovery amounts for each relevant scheme under its annual pricing proposal.
  - The new cost recovery mechanism allows adjustment for any over/under recovery from the previous two regulatory years to be carried out. Given that actual full-year data for a previous regulatory year would not be available at the time a pricing proposal is being prepared for the new regulatory year, the adjustments for over/under recovery would be permitted for the previous two regulatory years to allow adjustments to be carried out accurately. This would include the ability to adjust for any over/under recovery in the last one or two years of a regulatory control period in the first or second year of the next regulatory control period as the case may be.
- (ii) The Rule as made includes a requirement under the distribution determination process for the DNSP to set out, for the AER's approval, how it would report on its recovery under the new cost recovery mechanism.
- Under this requirement, the AER would make a decision in the distribution determination process on how a DNSP is to report to the AER on its recovery of the payments under the relevant jurisdictional schemes.
- (iii) The Rule as made provides that payments made (or credits given) under current jurisdictional schemes and any new schemes, which meet the defined criteria, may be recovered using this mechanism.
- The new provision includes the ability for payments made under a new jurisdictional scheme introduced part way through a regulatory control period to be recovered in the current regulatory control period. This would be subject to the new jurisdictional scheme meeting the jurisdictional scheme eligibility criteria and the DNSP meeting relevant reporting requirements.
- (iv) The Rule as Made includes transitional provisions to enable the Rule as Made to be applied during the current regulatory control period.
- The transitional provisions include the option for a DNSP to decide whether or not to adopt the new cost recovery mechanism in the current regulatory control period.<sup>13</sup>

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<sup>13</sup> It is noted that the option for the DNSPs is whether or not to adopt the new cost recovery mechanism in the current regulatory control period. The new cost recovery mechanism will apply for all relevant approved jurisdictional schemes for the next regulatory control period for all DNSPs.

- If a DNSP elects to opt in to the new cost recovery mechanism in the current regulatory control period, the transitional provisions require the DNSP to make an election to the AER and an application to the AER setting out how the DNSP would report to the AER on its recovery of the payments under the pricing proposal process. Where applicable, the AER would also need to undertake a revocation and substitution of the distribution determination. That is, in the case where a DNSP's distribution determination has taken into account the recovery of payments to be made under these schemes, the DNSP may elect to use the new cost recovery mechanism instead and the following steps would be carried out:
  1. under clause 11.35.4(a)(2) - the DNSP gives written notice to the AER that it intends to make an election under clause 11.35.2(c) of the Rules to use the new cost recovery mechanism. (That is, this step would need to take place well in advance of the formal "election" under Rule 11.35.2(c) to allow steps (2) and (3) below to be completed);
  2. under clause 11.35.4 - the AER starts the process to consider a revocation and substitution of the DNSP's distribution determination;
  3. under clause 11.35.3 - the DNSP requests the AER to determine how the DNSP is to report to the AER on its recovery of jurisdictional scheme amounts. Clause 6.6.1A(c) to (f) would apply where the AER would have 60 business days to make a decision;
  4. under clause 11.35.2 - subject to the completion of steps (1), (2) and (3) above, the DNSP makes an election by written notice to the AER at least 20 business days before the date that a pricing proposal is required to be submitted.
- Amendments have also been made to transitional Chapter 6 of the Rules that applies to NSW and ACT for the 2009-2014 regulatory control period to provide the option for DNSPs in NSW and ACT to adopt the new mechanism in the current regulatory control period.
- Amendments have also been made to the provisions to allow adjustments for over/under recovery for payments made by NSW DNSPs to the Climate Change Fund to be made through the pricing proposal process.

The Rule proposed by ETSA Utilities included amendments to clauses related to billing. It was proposed that a new category of charges be added for the recovery of payments made under feed-in schemes or climate change funds, which would be separate from distribution use of system charges. The Rule as Made does not include such amendments. The Commission notes that the obligations to make payments under the jurisdictional schemes are imposed on DNSPs in their capacity as DNSPs. In addition, DNSPs do not provide separate services in exchange for the payments. For these reasons, the Commission considers the recovery of the payments may be charged as a part of the price for providing distribution services, which would be a component of the distribution use of system charge.

### 3.3 Difference between the Rule as Made and Draft Rule

Taking into consideration issues raised in the second round of consultation, amendments were made. The Rule as Made differs from the Draft Rule in the following ways:

- **Amendments to jurisdictional schemes** - the Draft Rule and the Rule as Made set out eligibility criteria that jurisdictional schemes need to meet. Given the possibility that jurisdictional schemes could be amended by legislation, the Rule as Made requires the DNSP to outline in its pricing proposal how any approved jurisdictional schemes that have been amended meet the jurisdictional scheme eligibility criteria.<sup>14</sup>
- **Adjustment for over/under recovery amounts** - the Draft Rule provided for any over/under recovery amount from the "preceding regulatory year" to be recovered. However, given that the relevant "preceding" year would not have ended at the time pricing proposals are being prepared, the Rule as Made permits over/under recovery amounts from the previous two regulatory years to be recovered.<sup>15</sup>
- **Transparency of reporting and the NSW Climate Change Fund** - the Draft Rule set out the requirement for DNSPs to seek the AER's approval on how they would report to the AER on the recovery of jurisdictional scheme amounts under the new cost recovery mechanism. As the recovery of payments made under the Climate Change Fund in NSW were provided for in an existing provision in transitional Chapter 6, this reporting requirement did not extend to the Climate Change Fund for the current regulatory period. However, the Rule as Made has a new provision that allows a DNSP to adjust for over/under recovery of payments to the Climate Change Fund payments. Given this provision, the Rule as Made requires a DNSP to set out, in the next pricing proposal, how it would carry out, and report on, the adjustment of over/under recovery of payments to the Climate Change Fund.<sup>16</sup>
- **Minor amendments** - other minor amendments to clarify the provisions have also been made. Additional details are set out in the responses to issues raised in the second round of consultation in Appendix A.2.

### 3.4 Civil Penalties

The Rule as Made does not amend any Rules that are currently classified as civil penalty provisions under the National Electricity (South Australia) Regulations. The Commission would not propose to recommend to the MCE that any of the proposed amendments in the Rule as Made be classified as civil penalty provisions as the Rule as

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<sup>14</sup> As discussed further in sections 7.3.1 and 7.3.2.

<sup>15</sup> As discussed further in section 6.3.

<sup>16</sup> As discussed further in section 8.3.



Made relates to the DNSPs' cost recovery processes under Chapter 6 of the Rules. The nature of the provisions under Chapter 6 of the Rules provides incentives to ensure that DNSPs adhere to the requirements so that their costs may be efficiently recovered.

## 4 Commission's assessment approach

This chapter describes the Commission's approach to assessing the Rule Change Request in accordance with the requirements set out in the NEL (and explained in Chapter 2).

In assessing this Rule Change Request, the Commission has considered the following issues:

- Administrative efficiency - the treatment of the recovery of payments under feed-in schemes under the current processes;
- Allocation of risks - how are risks associated with forecasting errors taken into account; and
- Accommodating future schemes - whether the proposed Rule, if made, should accommodate feed-in schemes, climate change funds and other schemes that may be introduced in the future.

In its assessment of the Rule Change Request, the Commission has also considered whether transitional provisions would be required to allow DNSPs to transition effectively to the proposed new cost recovery mechanism.

The Commission has focussed on these issues because they relate to the objectives and principles of the regulatory framework under Chapter 6 of the Rules. These objectives and principles include:

- Achieving a balance between the interests of DNSPs and end-use customers;
- Providing transparent and timely regulatory processes; and
- Increasing regulatory certainty and reducing the administrative burden on DNSPs and the AER.

## 5 Administrative efficiency

This chapter sets out the Commission's considerations in relation to the efficiency of the treatment of the recovery of payments under feed-in schemes and climate change funds using the current provisions under the Rules.

### 5.1 Rule Proponent's view

The Rule Proponent submitted that the current treatment of the recovery of payments made by DNSPs under feed-in schemes and climate change funds in the distribution determination process was not efficient. In the Rule Change Request, it was noted that the amount of forecast feed-in tariff payments included in DNSPs' operating expenditure would have to be assessed for efficiency by the AER under the distribution determination process. The Rule Proponent considered this would be "a needless assessment as it is a regulatory obligation for DNSPs to pay out for electricity generated using eligible systems regardless of whether it does in fact reflect efficient costs".<sup>17</sup>

Similarly, the Rule Proponent argued that the use of the pass through mechanism under Chapter 6 of the Rules to adjust any over and under recovery would also be inefficient and present an administrative burden on DNSPs and the AER. The pass through mechanism involves an application and assessment process to ensure that only efficient costs would be allowed to be passed through to customers, which would not be applicable to these payment amounts which are set by legislation. For this reason, the Rule Proponent considered that the use of the pass through mechanism for these payments would result in "frequent and unnecessary assessment processes" by DNSPs and the AER.<sup>18</sup>

### 5.2 Stakeholders' views

In submissions received in the first round of consultation, stakeholders agreed in principle with the Rule Proponent's views on the issue of administrative efficiency. It was considered that the current treatment of the recovery of payments made by DNSPs under feed-in schemes and climate change funds should be addressed under the pricing process rather than under the distribution determination process.

However, some stakeholders noted the importance of distinguishing between costs incurred by a DNSP in administering/operating the schemes, and any system costs, from the actual payment amounts. These stakeholders agreed that the costs for administering the scheme should be considered as operating expenditure under the distribution determination process. These stakeholders noted that these costs would be within the control of the DNSP and, hence, should be subject to efficiency considerations.

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<sup>17</sup> ETSA Utilities' Rule Change Request, p. 7.

<sup>18</sup> *ibid*

Some DNSPs also queried how the pass through process would be applied in practice to enable any over/under recovery to be adjusted. These DNSPs noted that any pass through application would be subject to a materiality threshold and questioned whether this threshold should be applied in principle. In addition, as the pass through mechanism relates to pass through amounts in a regulatory control period, concerns were raised as to whether the pass through mechanism could effectively provide for the adjustment of any over/under recovery that occurs in the last year of a regulatory control period.<sup>19</sup>

Additional details of the issues raised by stakeholders in the first and second rounds of consultation are provided in Appendix A.1 and Appendix A.2 respectively.

### **5.3 Commission's analysis**

The Rule Change Request proposed to add a new cost recovery mechanism under the pricing process on the basis that the current treatment of the recovery of payments made under feed-in schemes was inefficient. The Commission has considered the application of the current distribution determination and pass through provisions in the assessment of this Rule Change Request.

#### **5.3.1 Distribution determination process**

In considering the issue raised of whether payments made by DNSPs under feed-in schemes and climate change funds should be considered as operating expenditure, the Commission considered the requirements for operating expenditure under the Rules. Clause 6.4.3 of the Rules sets out the applicable building blocks to be used in the distribution determination for DNSPs and one of these building blocks is forecast operating expenditure. The forecast operating expenditure is the forecast operating expenditure for a regulatory control period a DNSP considers is required to achieve the operating expenditure objectives, which are to:<sup>20</sup>

1. meet or manage the expected demand for standard control services over that period;
2. comply with all applicable regulatory obligations or requirements associated with the provision of standard control services;
3. maintain the quality, reliability and security of supply of standard control services; and

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<sup>19</sup> Submissions to the AEMC's review on the Request for Advice on Cost Recovery for Mandated Smart Metering Infrastructure also raised this issue, which was referred to as the "dead zone" issue. In the AEMC's draft report on this review, a draft finding acknowledged this issue and considered that the Rules should be amended to ensure the cost pass through timeframes are appropriate for a mandated smart meter roll-out. See AEMC, *Request for Advice on Cost Recovery for Mandated Smart Metering Infrastructure, Draft Report*, 18 June 2010, pp. 41, 47, 55-57.

<sup>20</sup> Clause 6.5.6(a) of the Rules.

4. maintain the reliability, safety and security of the distribution system through the supply of standard control services.

The Commission notes that any forecast operating expenditure included in a regulatory proposal would then need to be assessed by the AER. In its assessment of a regulatory proposal, the AER must be satisfied that the forecast operating expenditure reasonably reflects:<sup>21</sup>

1. the efficient costs of achieving the operating expenditure objectives;
2. the costs that a prudent operator in the circumstances of the relevant DNSP would require to achieve the operating expenditure objectives; and
3. a realistic expectation of the demand forecast and cost inputs required to achieve the operating expenditure objectives.

Although the costs incurred by DNSPs under feed-in schemes and climate change funds may, in some respects, fall within the requirements for operating expenditure under clause 6.5.6(a) of the Rules, the Commission agrees with the issue raised in submissions that a distinction is required between the operating and system costs that may be incurred by DNSPs in complying with the regulatory obligations, and the actual payments (or credits) that DNSPs are required to make to other parties under those obligations. The Commission considers that the costs to administer and comply with these schemes would fall under costs required to comply with regulatory obligations or requirements associated with the provision of standard control services, in the same way as administrative costs for complying with other regulatory obligations faced by DNSPs. For this reason, the Commission considers that the costs for administering the schemes would be within the requirements for operating expenditure under the Rules and not require any additional clarification under the Rules.

Amounts of monies that DNSPs are required to pay (or credits that DNSPs are required to apply) as specified by legislation are not operating expenditure within the control of DNSPs. While it would be prudent to assess operating expenditure within the control of DNSPs for efficiency, there appears to be no additional benefits for including the payment amounts under jurisdictional schemes such as feed-in schemes and climate change funds in the building block process.

For these reasons, the Commission considers that it would be appropriate to consider the recovery of the payment amounts (or the revenue foregone in applying credits) through the pricing process as this would contribute to administrative and productive efficiency by removing the requirement for DNSPs to include the payment amounts as forecasting operating expenditure in its regulatory proposal and, hence, removing the requirement for the AER to consider the payment amounts in the distribution determination process.

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<sup>21</sup> Clause 6.5.6(c) of the Rules.

### 5.3.2 Pass through process

In considering whether the issue raised by the Rule Change Request about the use of the pass through mechanism to address over/under recovery of payments made by DNSPs under feed-in schemes, the Commission considered the current pass through provisions under the Rules.

Consistent with the revenue and pricing principles, which include ensuring service providers are provided with a reasonable opportunity to recover efficient costs they incur in providing standard control services, the revenue process under Chapter 6 of the Rules includes a pass through mechanism to provide a degree of protection against, and a mechanism to manage, uncertainties that are inherent in the market.<sup>22</sup> The pass through mechanism requires the AER to make a determination on any pass through application taking into account various factors including the efficiency of a DNSP's decisions and actions in relation to the pass through event.<sup>23</sup> This ensures that the pass through mechanism would only be used for unexpected costs that would not otherwise be compensated in the DNSP's distribution determination. The pass through mechanism also contains other safe-guards, such as requiring the DNSP to provide appropriate evidence and allowing the AER to consult with other stakeholders, to ensure that only relevant and efficient costs would be passed through.<sup>24</sup>

The Commission considers that each pass through event would typically relate to one specific change in circumstances that was unknown at the time of making a distribution determination. In the case of the adjustments for the recovery of payments under feed-in schemes, the adjustments would be "known events" that would be expected to occur more than once (and possibly at least once a year) in the regulatory control period. Each application would impose administrative requirements on the DNSP and the AER to undertake the pass through application and assessment.

Given the Commission's considerations in section 5.3.1 that the recovery of payments made by DNSPs under jurisdictional schemes, such as feed-in schemes and climate change funds, should be included in the pricing process, the adjustments of any over/under recovery should also be addressed under the pricing provisions. That is, adjustments should be able to be made on an annual basis by including the relevant changes in the DNSPs' annual pricing proposals. This would enhance administrative efficiency as the administrative requirements that would be imposed on DNSPs and the AER under the pass through mechanism would no longer be required for these adjustments.<sup>25</sup>

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22 The pass through mechanism is set out under clause 6.6.1 of the Rules.

23 The factors the AER is to take into account in making a pass through determination are set out in clause 6.6.1(j) of the Rules.

24 Requirements for a DNSP to provide evidence in its application for a pass through is set out in clause 6.6.1(c)(6) in respect of positive pass through events; and the provisions allowing the AER to consult on pass through applications is set out in 6.6.1(l).

25 Clause 6.18.6 of the Rules.

## 5.4 Commission's conclusion

The Commission concludes:

- Payment amounts mandated by legislation - as the payments that DNSPs are required to make under jurisdictional schemes, such as feed-in schemes and climate change funds, are mandated by legislation, a new cost recovery mechanism would be appropriate to address the recovery of these payments;
- Pricing process - a new cost recovery mechanism would remove the need for the actual payment amounts to be considered under the distribution determination process and for adjustments for over/under recovery to be considered under the pass through process;
- Productive and administrative efficiency - a new cost recovery mechanism would provide a new mechanism for the recovery of a type of cost that otherwise would have no explicit cost recovery mechanism under the Rules. Promoting efficiency in the operation of electricity services would minimise the costs faced by DNSPs and the AER, and hence should be in the long term interest of consumers with respect to the price of supply of electricity.

It would be appropriate for a DNSP to be able to make adjustments under its pricing proposals to account for any over/under recovery of payments made under jurisdictional schemes such as feed-in schemes and climate change funds. Following from this provision, the Commission notes that, if a Rule was made, consequential amendments would be required to exclude such adjustments from the "permissible percentage" that restricts the extent the weighted average revenue for a DNSP may change from one regulatory year to the next.

## 6 Allocation of risks

This chapter sets out the Commission's considerations in relation to how the risks associated with forecasts of operating expenditure under the distribution determination process would be taken into account under the current provisions in the Rules.

### 6.1 Rule Proponent's view

Under the current treatment of the recovery of payments made under feed-in schemes, a DNSP would be required to produce a five-year forecast of the payments that it may make during its regulatory control period. The Rule Proponent considers that the level of payments that a DNSP would be required to make would be subject to various factors outside of the DNSP's control. Hence, the Rule Proponent argued that a forecast made up to five years in advance, despite the DNSP's best efforts, could "be significantly inaccurate due to the behaviour of other parties".<sup>26</sup> The Rule Proponent submitted that DNSPs would "inefficiently be asked to bear the risk" of these forecasting errors.<sup>27</sup>

### 6.2 Stakeholders' views

In submissions received in the first round of consultation, stakeholders agreed in principle with the Rule Proponent's views on this issue. In addition, some stakeholders considered that adjusting over/under recovery through the pass through mechanism would, in effect, delay the adjustment by two years. These stakeholders argued the proposed Rule would contribute to allocative efficiency by allowing adjustments for over/under recovery to be made through the annual pricing proposal process.

In submissions received in the second round of consultation, stakeholders generally supported the proposed cost recovery mechanism and the provisions for over/under recovery. However, CitiPower and Powercor noted that pricing proposals must be submitted approximately two months before the commencement of the next regulatory year and, accordingly, it would not be possible to determine the exact amount of any over/under recovery from the "preceding year" at that time. DNSPs would be required to estimate a component of the payments in the preceding year. Therefore, by restricting the adjustment of over/under recovery amounts to amounts from the preceding regulatory year, CitiPower and Powercor considered that accurate and efficient recovery of over/under recovery amounts would not be possible.<sup>28</sup> In addition, CitiPower and Powercor also considered that the draft Rule did not take into account the time value of money of any over/under recovery amounts and, hence, proposed that the over/under recovery amounts be adjusted to account for inflation and the DNSP's nominal weighted average cost of capital (WACC).

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<sup>26</sup> ETSA Utilities Rule Change Request, p. 7.

<sup>27</sup> *ibid*

<sup>28</sup> CitiPower and Powercor, submission to the second round of consultation, 21 May 2010, p. 2.



Additional details of the issues raised by stakeholders in the first and second rounds of consultation are provided in Appendices A.1 and A.2 respectively.

### **6.3 Commission's analysis**

In considering this issue, the Commission has given consideration to the current requirements for forecasts to be produced under the Rules compared with the proposed provisions in the Rule Change Request.

#### **6.3.1 Risk of forecasting error and transparency of reporting**

Any prudent operator of a distribution business would put in place mechanisms and processes to enable it to carry out its business and regulatory obligations. This would include appropriate mechanisms for forecasting business requirements including operating expenditure and capital expenditure. However, as with forecasts of any nature, there are inherent risks that the actual outcomes would differ from the forecast values. Businesses have the ability to minimise these risks by ensuring that the forecasting methods adopted are robust and steps are taken to reduce forecasting errors. In the case of forecasting the level of payments that would be required under a feed-in scheme, the Commission acknowledges the factors that would need to be taken into account would largely be outside the control of DNSPs.<sup>29</sup>

For this reason the Commission considers that the risks presented by potential forecasting errors would be reduced by providing for the recovery of payments under jurisdictional schemes under the annual pricing process, as discussed in section 5.3.1. Although DNSPs would still be required to produce a forecast under an annual pricing process, the forecast would be an annual forecast using the latest available information. This annual forecast would likely be more accurate than a five-year forecast under the distribution determination process.

However, given the potential for errors in any forecast, there should be a level of clarity and transparency in the way in which DNSPs would report to the AER on how it intends to recover the payment amounts and make any adjustments for over/under recovery. That is, although a mechanism for the recovery of these payments should be included in the pricing process, DNSPs should include information on its reporting methodology in its regulatory proposals.

#### **6.3.2 Efficiency and accuracy of payment forecasts**

Under the current treatment of the recovery of payments under feed-in schemes, where the amount of money actually recovered by a DNSP differs from the forecast amount, the pass through mechanism would be employed to make any adjustments as

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<sup>29</sup> For example, some of the factors that may need to be taken into account in forecasting the required payments under a feed-in scheme would include the rate of take up of eligible installations; the average capacity of these installations; and the interaction of the scheme with other regulated schemes/programs.

discussed in section 5.3.2. Following the receipt of the pass through application, the AER would have up to 60 business days to make a determination for any positive change event.<sup>30</sup> Once the AER has made a determination, the DNSP would be able to make its revenue adjustments in the next regulatory year, which may be up to two years after the variation in cost recovery occurred.

Including an ability for adjustments for over/under recovery to be made through the annual pricing proposal process, adjustments for over/under recovery could be made more quickly. This would increase the likelihood that the customer base from which the costs are recovered from are reflective of the customers in relation to whom the costs were initially incurred.

Giving consideration to the issues raised in the second round of consultation, the Commission acknowledges that at the time a pricing proposal is being prepared for a regulatory year, it would not be possible to determine exact over/under recovery amounts for the "preceding regulatory year" as the relevant preceding year would not have ended. For this reason, the Commission considers that the adjustment of any over/under recovery amounts should extend to the preceding two regulatory years to allow for accurate cost recovery. Given that, where actual data were not available, DNSPs would estimate the payment amounts, the over/under recovery adjustments would need to compare the actual amounts paid/recovered by DNSPs with the relevant estimates. However, the Commission notes that, to the extent that actual data would be available at the time a pricing proposal is being prepared, a DNSP would be expected to calculate accurate over/under recovery amounts using actual data. With regard to the proposal to adjust the over/under recovery amounts for inflation and account for the DNSP's WACC, the Commission understands that, in practice, the over/under recovery amounts would be subject to indexation by the AER.<sup>31</sup>

## 6.4 Commission's conclusion

The Commission concludes:

- Efficiency and accuracy of payment forecasts - there should be a process that would likely lead to DNSPs being able to produce more accurate forecasts and allow for costs to be recovered closer to the time they were incurred. This would reduce the risks faced by businesses and consumers arising from forecast errors, which would reduce the costs to business of managing these risks, and hence should be in the long term interest of consumers with respect to the price of supply of electricity; and
- Transparency of reporting - reporting requirements would provide transparency to the processes being adopted by DNSPs and, hence, better balance the interests of consumers and businesses.

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<sup>30</sup> Clause 6.6.1(e)

<sup>31</sup> See for example the treatment of the "overs and unders" account for the recovery of transmission use of system charges by ActewAGL. AER, *Australian Capital Territory distribution determination 2009-2010 to 2013-2014*, 28 April 2009, p. 183.

## 7 Accommodating future schemes

This chapter sets out the Commission's consideration of how payments made under any future schemes to be introduced by jurisdictions should be treated.

### 7.1 Rule Proponent's view

In the Rule Change Request, the Rule Proponent noted that jurisdictions had introduced, or were in the process of introducing, feed-in schemes and that NSW had in place a Climate Change Fund. The Rule Change Request also noted that "[t]here is the potential ... that more such schemes would be introduced".<sup>32</sup>

### 7.2 Stakeholders' views

In submissions received in the first round of consultation, most stakeholders supported the principle that DNSPs should be able to use the mechanism under the proposed Rule, if made, to recover payments made under current and future feed-in schemes or climate change funds. However, one stakeholder noted that it may be difficult in practice to determine which schemes should be included.

In submissions received in the second round of consultation, some stakeholders sought clarification on whether the new cost recovery mechanism would apply for relevant Acts of the Commonwealth. The NSW Department of Industry and Investments also considered that an addition should be made to clarify that a jurisdictional schemes would remain "approved" if any legislative or regulatory amendments were subsequently made to the scheme.<sup>33</sup> The AER also proposed that the criteria for the new schemes should include that the schemes set out how the costs should be allocated amongst customers.<sup>34</sup>

Additional details of the issues raised by stakeholders in the first and second rounds of consultation are provided in Appendix A.1 and A.2 respectively.

### 7.3 Commission's analysis

The Commission's analysis on how any new schemes should be accommodated is set out as follows.

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<sup>32</sup> ETSA Utilities Rule Change Request, p. 1.

<sup>33</sup> NSW Department of Industry and Investments, submission to the second round of consultation, 20 May 2010, p. 1.

<sup>34</sup> AER, submission to the second round of consultation, 20 May 2010, p. 2.

### 7.3.1 Whether new schemes should be accommodated

The Commission considers there is some likelihood that other jurisdictional schemes, similar to the current feed-in schemes and climate change fund, would be introduced in the future. Ideally any new jurisdictional schemes should set out how the costs incurred would be recovered, including how the costs should be allocated among different customer classes. However, to consider the efficient application of any new cost recovery mechanism, the Commission has assessed whether new jurisdictional schemes should be accommodated.

Giving consideration to the revenue and pricing principles, including ensuring that DNSPs are provided with reasonable opportunity to recover efficient costs, the Commission considers that DNSPs should be able to recover any costs that are imposed on DNSPs in their capacity as DNSPs under legislation and where there are no other means of recovering those costs.<sup>35</sup> These considerations apply equally to State or Commonwealth legislation. For these reasons, the Commission considers that provisions should be put in place to accommodate the recovery of payments when they are required to be made under relevant future schemes under Acts of States and the Commonwealth.<sup>36</sup>

If the proposed cost recovery mechanism did not apply to new schemes, DNSPs would potentially need to attempt to recover any payments to be made through a pass through application or by including the provisions as operating expenditure in its regulatory proposal. As discussed in section 5, some aspects of these cost recovery processes may not present the most efficient option. Allowing a new cost recovery mechanism to apply to future schemes would contribute to productive efficiency by removing the potential requirement for the recovery to be considered under the distribution determination and/or pass through process.

The Commission considers that criteria should be established to ensure that any future schemes would be consistent with the intent of any Rule to be made. One of the key considerations under the Rule Change Request is that the recovery of the payment amounts mandated under legislation should not be required to be assessed under the distribution determination process as the payment amounts are unrelated to a DNSP's efficiency. This consideration should be reflected in the criteria. That is, in order for the proposed new cost recovery mechanism to apply to any future schemes, the amounts to be paid must be specified in, or determined in accordance with legislation and not in nature of a fine, penalty or incentive for DNSPs. Although it might be ideal for a scheme to set out how the recovery of payments should be allocated to customers, the Commission does not consider that this provision should be included in the criteria. The ability for DNSPs to recover such costs should not be limited by whether the

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<sup>35</sup> This would exclude payments in nature of fines, penalties or incentives.

<sup>36</sup> The Rule as Made includes a definition of "jurisdictional scheme obligations", which includes reference to "Acts of a participating jurisdiction". The Commonwealth is a participating jurisdiction within the meaning of section 5 of the NEL because there is a law of the Commonwealth (the Australian Energy Market Act 2004 (Cwlth)) that corresponds to Part 2 of the National Electricity (South Australia) Act 1996 (SA).

relevant schemes explicitly set out how the costs should be allocated. Where the scheme contains no explicit provisions for how costs should be allocated amongst customer classes, the DNSPs would have discretion in their pricing proposals.

The criteria should also specify that there are no specific cost recovery mechanisms set out in the relevant legislation (or that the legislation specifically refers to the recovery of payments to be addressed under the Rules). This criterion would be included for clarity to ensure that, where cost recovery provisions have been specified, there would be no conflict between the provisions under the Rules and other regulatory instruments.

In addition, the Commission considers that an additional factor should be included in the criteria such that the obligations under the scheme need to be imposed on DNSPs in their capacity as DNSPs. This would be required as the Commission's Rule making powers relate to the regulation of prices charged, or that may be charged, by DNSPs for the provision of distribution network services.<sup>37</sup>

That is, the criteria a future scheme would need to meet in order for the new cost recovery mechanism to apply should be:

- the scheme is a jurisdictional/government mandated scheme (either through legislation or licence conditions or any other relevant instruments);
- the scheme does not specify any cost recovery methods or the scheme specifies that the payments be recovered under the Rules;
- the amount of the payments to be made by DNSPs are specified or determined in accordance with the relevant instruments;
- the obligations are imposed on DNSPs in their capacity as DNSPs; and
- the payments are not in the nature of a fine, penalty or incentive for the DNSP.

### **7.3.2 Introduction of a new scheme**

Having established criteria that new schemes would need to meet, the Commission considers it would be appropriate to include a process for new schemes to be considered. The AER should be the body to determine whether any new schemes meet the eligibility criteria. This would be consistent with the AER's obligations under Chapter 6 of the Rules.

As discussed in section 6.3.1 the AER would make a decision in the distribution determination on how a DNSP would report on the recovery of the payments under jurisdictional schemes. If a new scheme were to be introduced part way through a

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<sup>37</sup> For example: if a DNSP was also the operator of the water distribution system in its jurisdiction, any obligations imposed on that DNSP in its capacity as the operator of the water distribution system would not be covered by the Rules. The Commission's power to make the Rule is discussed in section 2.3.

regulatory control period, DNSPs should make an application to the AER to set out their reporting methods for approval. Provisions outlining the process to be followed by DNSPs and the AER in the event a scheme is introduced part way through a regulatory control period would therefore need to be set out. Such a process would provide transparency and clarity on the processes undertaken by a DNSP.

Given that new jurisdictional schemes would need to meet the eligibility criteria, and existing jurisdictional schemes may be amended by legislation, provisions should be put in place to ensure that any amendments to an existing scheme for which cost recovery was sought would continue to meet the eligibility criteria. For this reason, DNSPs should be required to outline in their pricing proposals how each approved jurisdictional scheme, that has been amended, meets the jurisdictional scheme eligibility criteria. In the case that a jurisdictional scheme were to be amended such that cost recovery provisions outside the Rules were established, the definition of jurisdictional scheme amounts should be clarified to ensure that any amounts to be recovered under the Rules would take into account any amounts a DNSP may have recovered through other means.

#### **7.4 Commission's conclusion**

The Commission concludes:

- Productive efficiency - allowing payments to be made under future schemes, subject to the schemes meeting the eligibility criteria, would contribute to productive efficiency by removing the potential requirements for the payments to be considered under the distribution determination/pass through provisions. Promoting productive efficiency would minimise the costs faced by DNSPs and the AER, and hence should be in the long term interest of consumers with respect to the price of supply of electricity;
- Applicable schemes - for clarity, the current schemes to which a new cost recovery mechanism would apply should be set out and clear criteria for any future schemes should be defined;
- Approving the reporting requirements - a process for the AER to decide on the reporting process undertaken by a DNSP for any new schemes, or any amended schemes, would provide transparency and clarity on the processes undertaken by DNSPs.

## 8 Transitional provisions

This chapter sets out the Commission's consideration of whether transitional provisions would be required if a Rule was to be made.

### 8.1 Rule Proponent's view

Given that the jurisdictional provisions differ in the commencement date of the schemes and arrangements that may already have been made for cost recovery, the Rule Change Request outlined that specific transitional provisions would need to be considered.<sup>38</sup>

### 8.2 Stakeholders' views

In submissions to the first round of consultation, stakeholders generally agreed that transitional provisions should be in place to ensure that DNSPs would be able to use any new cost recovery provision in a timely manner. It is noted that although ActewAGL agreed with the principles of the Rule Change Request, it considered that given the ACT distribution determination for the 2009-2014 regulatory control period has already been made, it would not be appropriate to require ActewAGL to adopt any new mechanism in the current regulatory control period.<sup>39</sup>

EnergyAustralia also noted that although the transitional Chapter 6 provisions provide a mechanism under the pricing provisions (similar to the proposed Rule) for the recovery of payments DNSPs make to the NSW Climate Change Fund, there are no provisions for any over/under recovery to be adjusted. In addition, EnergyAustralia noted that these existing provisions would need to be added to general Chapter 6 of the Rules to allow NSW DNSPs to continue its recovery of payments made to the Climate Change Fund after the transitional Chapter 6 provisions expire.<sup>40</sup>

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<sup>38</sup> With respect to arrangements that may already have been made for cost recovery of payments under feed-in schemes and climate change funds, it is noted that for: ActewAGL, provisions are included for the payments as a component of its operating costs outlined in its distribution determination for the regulatory control period 2009-2014; ETSA Utilities, provisions are included for the payments as a component of its operating costs outlined in its distribution determination for the regulatory control period 2010-2015; Queensland DNSPs, provisions are included for the payments as a component of their operating costs outlined in their distribution determination for the regulatory control period 2010-2015; New South Wales DNSPs, provisions are included in the transitional Chapter 6 provisions for the recovery of payments made under the Climate Change Fund; Victorian DNSPs, provisions are included in the feed-in legislation specifying payments for the scheme in the current regulatory control period should be recovered under the pass through mechanism under the Rules.

<sup>39</sup> ActewAGL, submission to the first round of consultation, 12 February 2010, p. 1.

<sup>40</sup> EnergyAustralia, submission to the first round of consultation, 12 February 2010, p. 6.

The NSW Government considered that any new cost recovery provisions should be able to be used by NSW DNSPs immediately.<sup>41</sup>

In submissions to the second round of consultation, Ergon Energy submitted that the revocation and substitution of a distribution determination process should set out a positive obligation for the AER to complete the review within a specific timeframe.<sup>42</sup> Energex also submitted that the revocation and substitution process may be onerous and, if it were to stay, supplementary guidance should be provided on how the distribution determination would be adjusted.<sup>43</sup>

Additional details of the issues raised by stakeholders in the first and second rounds of consultation are provided in Appendix A.1 and A.2 respectively.

### **8.3 Commission's analysis**

The Commission's analysis on the relevant requirements for transitional provisions are set out as follows.

#### **8.3.1 General transitional provisions**

If a Rule was to be made, the Commission considers there would be merit in allowing any new cost recovery mechanism to be implemented by DNSPs in their current regulatory control periods. This would allow the administrative efficiency as discussed in chapter 5 to be realised for DNSPs and the AER. For this reason, transitional provisions should be established to allow DNSPs to utilise the new cost recovery mechanism in a timely manner. Any process established should provide clarity and certainty to ensure a smooth transition from decisions made under the current arrangements to the new provisions.

However, the Commission notes that the general policy approach has been not to interfere with actions previously taken or decisions made under the existing regulatory framework. Distribution businesses make investment decisions into the future based on decisions made under the distribution determination process. Taking this into consideration, the ability to transition to the new cost recovery mechanism should be optional for DNSPs. This would provide a balance between the potential benefits that may be gained and maintaining regulatory certainty. This balance would be in the interest of the market as regulatory certainty contributes to good decision making by businesses.

The Commission notes that a distribution determination has already been made for ActewAGL for its current regulatory control period which sets out the recovery of payments made under the ACT feed-in scheme. Similar provisions were also put in

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<sup>41</sup> NSW Department of Industry and Investment, submission to the first round of consultation, 12 February 2010, p. 3.

<sup>42</sup> Ergon Energy, submission to the second round of consultation, 21 May 2010, p. 2.

<sup>43</sup> Energex, submission to the second round of consultation, 21 May 2010, p. 2.



place for ETSA Utilities, Ergon Energy and Energex for the regulatory control period 2010-2011 to 2014-2015. For this reason, any transitional provisions would need to include a process for the AER to make a revocation and substitution of a DNSP's distribution determination. This would allow the operating expenditure forecasts to be revised in order to remove the component for tariff payments to be made under feed-in schemes. This amendment of the distribution determination would be necessary to ensure that there would be no "double counting" of the recovery amounts.

The process for this revocation and substitution of the distribution determination should be consistent with the current process for revocation and substitution of distribution determination under the Rules.<sup>44</sup> Given that the circumstances for each DNSP may differ from other DNSPs, the Commission does not consider that specific criteria should be set out in the Rules on how the AER may conduct the revocation and substitution. In addition, the process should not set out specific timeframes to allow flexibility to both the AER and DNSP to ensure relevant issues would be appropriately assessed. This would be consistent with the existing revocation and substitution provisions under the Rules. The provisions should require the AER to consult with the DNSP prior to making a determination. These provisions would provide certainty to the DNSP as well as flexibility to both the DNSP and the AER to ensure that sufficient time is available to discuss relevant issues. In addition, taking into consideration the different circumstances of each DNSP, adopting the new cost recovery mechanism (and hence the requirement for a revocation and substitution of the distribution determination) should be optional. This would allow each DNSP to assess its situation and evaluate its individual requirements.

In addition, the transitional provisions should also require the DNSP to outline to the AER how it would report on its recovery of payments under the relevant jurisdictional scheme for that DNSP. This requirement would ensure there would be transparency on the reporting to be adopted going forward.

### **8.3.2 NSW and ACT transitional provisions**

The Commission notes that no provisions were made in the NSW DNSPs' 2009-2014 distribution determinations for the payments that the DNSPs would be required to make under the NSW Solar Bonus Scheme, which commenced on 1 January 2010. In this case, if the Rule was made, the AER would not be required to make a revocation and substitution of the NSW DNSPs' distribution determinations. NSW DNSPs should be able to apply the proposed new cost recovery mechanism directly subject to meeting the relevant transitional reporting requirements. As discussed in section 5.3.1, the Commission notes that the proposed new mechanism would only provide for the recovery of the actual payment amounts that the NSW DNSPs would be required to make, which would not include any operating or capital expenditure required to administer the scheme or carry out system upgrades.

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<sup>44</sup> Clause 6.13 of the Rules provides for the AER to make a revocation and substitution of a distribution determination for wrong information or error.

The Commission also acknowledges the issue raised by EnergyAustralia regarding there being no mechanism under the transitional Chapter 6 provisions for any over/under recovery of the payments made to the NSW Climate Change Fund to be adjusted. The Commission considers that an appropriate mechanism should be added to allow NSW DNSPs to adjust any over/under recovery of payments made to the NSW Climate Change Fund under the pricing process in the transitional Chapter 6 as the payments to be made are imposed on DNSPs by legislation. However, consistent with the considerations regarding reporting and transparency discussed in section 6.3.1 above, DNSPs should be required to report on how the over/under recovery would be adjusted. Given the general provision for the recovery of payments under the Climate Change Fund is an existing provision under the Rules, it would be desirable to ensure any reporting requirement did not affect the existing obligations on DNSPs. For this reason, DNSPs should be able to set out the reporting provisions relating to the recovery of over/under amounts for payments under the Climate Change Fund in the next pricing proposal. The Commission considers that, if the Rule is made, the NSW DNSPs would be able to utilise the new cost recovery provisions in the general Chapter 6 for subsequent regulatory control periods for the recovery of payments made under the Climate Change Fund.

#### **8.4 Commission's conclusion**

The Commission concludes:

- Timely implementation - transitional provisions to allow the new cost recovery mechanism to be implemented in a timely manner should be included which would allow the potential efficiency gains to be realised sooner;
- Regulatory certainty - however, to balance the potential benefits with maintaining regulatory certainty, utilising the new cost recovery mechanism should be optional for DNSPs during the current regulatory control period; and
- NSW and ACT provisions - provisions for NSW and ACT should be included to address specific NSW issues arising from the Rule Change Request.

## Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Commission	See AEMC
DNSPs	distribution network service providers
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEO	National Electricity Objective
NER	National Electricity Rules
Rule Proponent	ETSA Utilities
Rules	See NER
WACC	weighted average cost of capital

## A Summary of issues raised in submissions

### A.1 First round of consultation

The first round of consultation on the Rule Change Request closed on 12 February 2010. In total, nine submissions were received. The issues raised in the submissions, and the AEMC's responses to these issues, are summarised in the following table.

Stakeholder	Issue <sup>45</sup>	AEMC Response
<b>General comments</b>		
ActewAGL Distribution (ActewAGL)	Supports in principle the mechanism proposed, however considers that clarification is required regarding the scope of the mechanism and the transitional arrangements. p. 1.	Specific transitional provisions have been developed to allow DNSPs to "opt in" to use the new cost recovery mechanism in the current regulatory control period. That is, it would not be a mandatory requirement to adopt the new mechanism in the current regulatory control period. Additional discussion is outlined in chapter 8.
CitiPower and Powercor	Supports the proposed Rule change. p. 1.	Comments have been noted.
EnergyAustralia	Supports the proposed Rule and considers the proposed mechanism is more appropriate than recovering the costs through the building block determination. p. 1.	Comments have been noted. Discussion on the building block distribution determination process is provided below and in chapter 5.
EnergyAustralia	Considers the proposed process would provide greater transparency to customers on the costs incurred under the schemes.	Comments have been noted. Discussion on transparency to customers is outlined in chapter 6.

<sup>45</sup> Page numbers refer to page numbers in the stakeholder's submission to the first round of consultation.

Stakeholder	Issue <sup>45</sup>	AEMC Response
EnergyAustralia	Considers the AEMC could include a provision which specifically identifies the relevant schemes at the date when the Rule is made. However, this would not preclude other schemes that meet the general definition. However, considers that only feed-in schemes and climate change funds should be subject to the provisions. Appendix p. 5.	Comments have been noted. The Rule as Made would apply to the existing schemes as specifically set out under the Rules. The Rule as Made also sets out eligibility criteria that would apply to any new jurisdictional scheme.
Energex	Supports the intent of the Rule change request and agrees with the rationale provided by the Rule Proponent. p. 1.	Comments have been noted.
Ergon Energy	Is generally supportive of the intent of the Rule Change Request. p. 1.	Comments have been noted.
Integral Energy	Supports the proposed amendments and submits that they be implemented immediately for distributors in NSW to assist the effective implementation of the NSW Solar Bonus Scheme. p. 1.	Comments have been noted. Transitional provisions for NSW DNSPs have been included and they provide for the new cost recovery mechanism to be implemented in the current regulatory control period. Additional discussion is outlined in chapter 8.
AER	Does not consider the Rule change should be treated as non-controversial as it gives rise to broader issues with the regime that need to be resolved. p. 2.	Comments have been noted.
EnergyAustralia	Considers the AEMC should expedite the Rule Change Request and include transitional provisions for NSW. p. 2.	Comments have been noted. Transitional provisions have been included as outlined in chapter 8.
AER	Supports in principle a Rule change that made clear to customers the costs of regulatory obligations, such as feed-in schemes, particularly where the services are not associated with the provision of distribution services. p. 3.	Comments have been noted.

Stakeholder	Issue <sup>45</sup>	AEMC Response
NSW Department of Industry & Investment (DII)	Notes that the NSW Government supports the overall principle outlined in the Rule Change Request as it would provide certainty of cost recovery for distributors for payments under feed-in schemes and climate change funds. p. 1.	Comments have been noted.
DII	Supports the payments made under the NSW Solar Bonus Scheme to be recovered from all NSW electricity customers. p. 2.	Comments have been noted.
Origin Energy	Considers that whatever methodology is chosen [for the recovery of these payments by DNSPs], it needs to align clearly and appropriately with the retail price methodologies in each jurisdiction. This is necessary to ensure that the regulated retail price in each jurisdiction enables full recovery of this charge in network costs. If it does not, then retailers will find themselves exposed to yet another unmanageable financial risk. p. 1.	The Commission considers that the payments made under jurisdictional schemes are imposed on DNSPs in their capacity as DNSPs. The Commission considers the recovery of the payments may be charged as a part of the price for providing distribution services and a new type of charge would not need to be created. For this reason, retailers should be able to pass through these costs to the same extent as existing network charges are passed through. Additional discussion is outlined in section 3.2.
AER	Notes that the feed-in tariff schemes to date have not indicated how the costs of the scheme should be recovered from customers. The pricing principles and the regulatory obligations on the DNSPs do not state which tariff classes should be targeted for the allocation of costs. While it is possible to make certain assumptions, it would be preferable if there was an explicit statement made in either the NER or in the regulatory obligations imposed on the DNSPs as to how the costs should be recovered. pp. 3-4.	The Commission notes the issues raised and agrees that how costs are to be recovered should be clarified within the jurisdictional schemes. The Commission notes that these issues, however, are outside the scope of the Rule Change Request and that policy makers would be required to provide direction on these issues in the relevant legislation establishing the schemes.

Stakeholder	Issue <sup>45</sup>	AEMC Response
<b>DNSP's operational costs and system costs</b>		
EnergyAustralia	Notes that there are two types of costs associated with these schemes - the payments made to eligible customers and the costs associated with administering the scheme. Notes that it agrees the costs associated with administering the scheme should be recovered through the building block determination/pass through mechanism. p. 2.	The Commission agrees that the costs of administering a jurisdictional scheme, such as a feed-in scheme or climate change fund, should be subject to the appropriate efficiency considerations. The new cost recovery mechanism should only be used to recover the actual payment amounts that are mandated by legislation.
AER	Notes that the Rule Change Request considers any assessment of efficiency in regard to feed-in tariff schemes as being needless. Notes that while this may be true in regard to the tariff payment, the administrative costs of such a scheme would be controllable by a regulated business and would give rise to efficiency considerations. p. 1.	As noted above, the Commission agrees with the principle that costs for administering a jurisdictional scheme would be a cost that was controllable by a regulated business.
DII	Notes that the tariff credited by DNSPs under the NSW Solar Bonus Scheme should be recovered through the proposed Rule change; whereas additional administrative costs such as costs to establish billing and reporting systems and the ongoing cost of meeting these requirements should be recovered through the normal regulatory determination process. p. 3.	As noted above, the Commission agrees with the principle that costs for administering a jurisdictional scheme would be controllable by a regulated business.
<b>Use of the distribution determination process</b>		
EnergyAustralia	Considers that payments made under feed-in schemes or climate change funds are payments outside the control of the distributor and therefore should not be subject to the incentives under a building block approach. p. 4.	The Commission agrees with this in principle. Additional discussion is outlined in chapter 5.

Stakeholder	Issue <sup>45</sup>	AEMC Response
EnergyAustralia	Considers that the payments made under feed-in schemes and climate change funds cannot be controlled or influenced through more efficient behaviour by the distributor. p. 4.	The Commission agrees with this in principle. Additional discussion is outlined in chapter 5.
Energex	Agrees that an ex-post assessment of actual payments is required as DNSPs do not have any control over the payments made under feed-in schemes and climate change funds. p. 1.	The Commission agrees with this in principle. Additional discussion is outlined in chapter 5.
AER	Distribution businesses' recovery the costs of these types of initiatives [feed-in schemes/climate change funds] through their chapter 6 determination is currently problematic. It is uncertain whether a number of these initiatives would fit within the definition of a distribution service for the purpose of chapter 6 of the NER. If the costs (or some of the costs) of these initiatives are to be recovered through the chapter 6 building block determination process, it is vital that the National Electricity Law and the NER clearly allow for this and the limitations in the current regime be addressed. p. 2.	The Commission agrees that the recovery of the payment amounts should be outside the building block process. Additional discussion is outlined in chapter 5.
DII	Considers that it is important that DNSPs are able to recover legitimate costs imposed on them either from Government or transmission businesses (as with transmission use of system charges), particularly where these costs are not able to be influenced by the behaviour of DNSPs, even where more efficient operating procedures are implemented. p. 4.	The Commission agrees with this in principle. Additional discussion is outlined in chapter 5.



Stakeholder	Issue <sup>45</sup>	AEMC Response
DII	Considers the Rule Change Request, if the proposed Rule were to be implemented, would provide greater clarity to DNSPS in recovering legitimate costs which DNSPs are not able to control through increases in efficiency; it reduces the administrative burden on the AER and DNSPs in pursuing cost pass through applications for feed-in tariff payments and recovery of shortfalls in network charges to cover costs under the [relevant funds]. p. 4.	The Commission agrees with this in principle. Additional discussion is outlined in chapter 5 and chapter 6.
<b>Function of the pass through mechanism</b>		
EnergyAustralia	Notes that under the pass through mechanism the AER would be required to assess each application in accordance with the Rules and any materiality threshold that applies, potentially on an annual basis. Considers that this annual process would be administratively cumbersome. Further considers it is unclear under the Rules where a distributor would obtain a pass through of costs to correct for under and over recovery of revenue in the last year of a regulatory control period. p. 5.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 5.
Energex	The pass through process under the Rules is considered to be more administratively burdensome on the DNSP and the AER than the determination of an adjustment factor for annual pricing. p. 1.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 5.
Ergon Energy	Believes that the Rule change is necessary in that an under-and-overs revenue adjustment for each regulatory year is more administratively simple to operate than the current approach proposed by the AER in Ergon's draft distribution determination. p. 1.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 5.

Stakeholder	Issue <sup>45</sup>	AEMC Response
Ergon Energy	Considers there is uncertainty with the pass through process for adjusting any over/under recovery as it is not yet known what level of detail and justification Ergon Energy will be required to provide as a part of this process. Any adjustments to the annual revenue requirement would take effect two years after the year in which the actual results differ from the forecast. p. 4.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 5.
DII	Considers that there is a degree of uncertainty as to what criteria, including materiality or level of costs, need to be met before the AER will allow these costs [for the NSW Solar Bonus Scheme] to be passed through. This uncertainty is heightened by the difficulty for DNSPs in forecasting costs under the scheme which are dependent on rates of uptake of small-scale generation by customers which are outside of DNSPs' control. p. 2.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 5.
<b>Forecasting and allocative efficiency</b>		
EnergyAustralia	Notes that the building block approach requires a five year projection of payments, while a pricing proposal is based on a yearly forecast which incorporates latest information on take-up rates and payment levels. There will consequently be less forecasting error under the proposed process. p. 5.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 6.
Energex	Considers that the dynamic nature of an annual adjustment mechanism can enhance the cost-reflectivity of annual distribution prices. Under the current treatment, the annual forecast and pass-through component reflect forecasts made up to five (or more) years previous to the year which they relate. An annual pricing adjustment mechanism would allow the components to reflect estimates made no more than two years previous to the year which they relate. p. 1.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 6.

Stakeholder	Issue <sup>45</sup>	AEMC Response
Ergon Energy	Considers the Rule Change Request allows for greater accuracy in forecasting payments under a feed-in scheme, as the forecasts can be done annually as part of the pricing proposal process rather than for a five year period prior to the commencement of the regulatory control period. p. 1.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 6.
Ergon Energy	Considers that forecasting payments under feed-in schemes is highly uncertain as the forecasts are based on projections of the behaviour of others over which DNSPs have no control. Considers that providing a five year forecast as part of a distribution determination process results in significant uncertainty for DNSPs and customers. pp. 2-3.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 6.
Integral Energy	Considers the proposed Rule change would minimise the uncertainty surrounding customer numbers and usage forecasts by applying a transmission use of system charges type cost recovery arrangement, which improves allocative efficiency and minimises the administrative burden on DNSPs. It also minimises the potential distortion in prices through an over and under recovery mechanism which is adjusted annually. pp. 2-3.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 6.
AER	Notes that under the proposed Rule, forecasts of payment amounts would still be required for the year ahead; an efficiency assessment would (presumably) still be needed in terms of any controllable costs; forecast errors would still occur and an adjustment would still be required. p. 4.	Comments have been noted. The Commission notes that DNSPs would still be required to produce annual forecasts under the Draft Rule. However, it is likely that annual forecasts would be more accurate than five-year forecasts that would be required under the distribution determination process. Additional discussion is outlined in chapter 6.

Stakeholder	Issue <sup>45</sup>	AEMC Response
DII	Considers that if the direct costs of these schemes are passed on to customers on an annual basis and reconciled each year through the unders and overs mechanism, network charges for customers associated with these costs are likely to be passed on closer to the time that the costs were incurred by DNSPs. p. 4.	Comments have been noted. The Draft Rule addresses this issue by providing for a new cost recovery mechanism under the pricing process. Additional discussion is outlined in chapter 6.
<b>Scope of the proposed new mechanism</b>		
ActewAGL	Considers the scope of the cost recovery mechanism must be clear and extend beyond photovoltaic schemes and accommodates all current and future renewable energy schemes. p. 2.	Comments have been noted. The scope of the new cost recovery mechanism under the Draft Rule does extend beyond photovoltaic schemes. Additional discussion is outlined in chapter 7.
Ergon Energy	Considers the any new process should be flexible enough to allow the various methodologies currently employed in various jurisdictions to be included. That is, the Rule change should not require the recovery of payments through individual specified components in the tariff and therefore network bill. pp. 1-2.	Comments have been noted. The DNSP would be required to specify the relevant schemes to which the cost recovery relates under the pricing proposal. However, no additional requirements have been included that would require DNSPs to specify the components in the network bill.
Ergon Energy	Considers it appropriate that given the schemes and funds are mandated by state governments, it would be appropriate for the Rules to include a set of criteria that a scheme would need to meet in order to use the cost recovery mechanism. Suggests that criteria specify that the scheme or fund is mandated by government; and has a regulatory requirement on the DNSP to make payments. p. 5.	Comments have been noted. Additional discussion is outlined in chapter 7.

Stakeholder	Issue <sup>45</sup>	AEMC Response
AER	Considers the proposed Rule would have the benefit of more transparently delineating costs associated with the provision of distribution services from the costs of certain types of regulatory obligations, like feed-in tariffs. Considers that, under such arrangements, the AER would have more of an audit function with regards to the recovery of payments under feed-in schemes. p. 1.	Comments have been noted. Additional discussion is outlined in chapter 6 and chapter 7.
AER	In regards to climate change funds, in the absence of more detail about the programs it is unclear whether the approach proposed would be appropriate or not. The initiative may not be as simple as the straight forward pass through of a cost over which a DNSP has no control. p. 2.	Comments have been noted. Additional discussion is outlined in chapter 7.
<b>Transitional arrangements</b>		
ActewAGL	Has concerns on the transitional arrangements. Does not believe the proposed Rule should provide grounds for reopening and amending the ACT determination. Considers it would not be appropriate to require ActewAGL to adopt the new mechanism as its determination has already been made. p. 2.	Comments have been noted. Under the Draft Rule, adopting the new cost recovery mechanism in the current regulatory control period would not be mandatory (however, it would be mandatory for subsequent regulatory control periods). DNSPs would be able to "opt in" to use the new arrangements in the current regulatory control period. Additional discussion is outlined in chapter 8.
Ergon Energy	Supports AEMC having due regard of the impact a Rule change will have on Ergon Energy's distribution determination when contemplating this proposed amendment to the Rules. Considers the AEMC should ensure that there is a transitional arrangement whereby Ergon Energy can immediately apply the Rule, therefore requiring an amendment to Ergon Energy's distribution determination. However, this is subject to the Rule change not specifying the way the payments should be recovered through network tariffs. p. 4.	Comments have been noted. Additional discussion is outlined in chapter 8.

Stakeholder	Issue <sup>45</sup>	AEMC Response
<b>NSW transitional provisions</b>		
EnergyAustralia	Noted that the proposed Rule does not seek to make any amendments to the transitional Chapter 6 provisions that apply to NSW and ACT. Considers that such amendments would be required. p. 6.	Comments have been noted and provisions have been included in the Rule as Made. Additional discussion is outlined in chapter 8.
EnergyAustralia	With the introduction of the NSW Solar Bonus Scheme for which DNSPs' costs have not been taken into account in their distribution determinations, considers that NSW DNSPs are at a disadvantage compared to other jurisdictions such as ActewAGL which have an allowance for payments incorporated into its X-factors. p. 6.	Comments have been noted. The Draft Rule provides for the recovery of these payments under the pricing process and includes the consequential amendment which would allow such an adjustment to be excluded from the side constraint calculations. Additional discussion is outlined in chapter 5.
EnergyAustralia	Considers that NSW DNSPs are exposed to uncertainty under the current Rules. It considers that any applications for pass through amounts to address the costs incurred under the Solar Bonus Scheme could be unsuccessful and, if successful, it is uncertain whether the pass through applications could be made to adjust for over and under recovery. p. 7.	Comments have been noted. The Draft Rule would provide NSW DNSPs with the option to "opt in" to the new cost recovery mechanism and thereby address the concerns raised. Additional discussion is outlined in chapter 8.
EnergyAustralia	Considers that the transitional Chapter 6 Rules should also be amended to provide for the recovery of payments made under the NSW Solar Bonus Scheme. p. 7.	Comments have been noted. Transitional provisions have been included. Additional discussion is outlined in chapter 8.
EnergyAustralia	Although the transitional Chapter 6 includes provisions for NSW DNSPs to recover under the pricing provisions payments made to the Climate Change Fund, EnergyAustralia notes there are no provisions to allow for the adjustment of any over/under recovery. Appendix p. 1.	Comments have been noted. Provisions have been added to allow adjustments for over/under recovery for payments made to the NSW Climate Change Fund to be made. Additional discussion is outlined in chapter 8.

Stakeholder	Issue <sup>45</sup>	AEMC Response
Integral Energy	Given the NSW Solar Bonus Scheme commenced on 1 January 2010, submits the proposed Rule change apply immediately to NSW DNSPs to moderate price impact on customers. p. 3.	Comments have been noted. The Draft Rule would provide NSW DNSPs with the option to "opt in" to the new cost recovery mechanism and thereby addressing the concerns raised. Additional discussion is outlined in chapter 8.
DII	Requests that transitional arrangements provide for the date of effect for the rule change to apply to NSW DNSPs with immediate effect. p. 3.	The Draft Rule would provide NSW DNSPs with the option to "opt in" to the new cost recovery mechanism and thereby addressing the concerns raised. Additional discussion is outlined in chapter 8.
<b>Drafting suggestions</b>		
CitiPower and Powercor	Proposes drafting suggestions to 6.18.7A(c)(2) for consideration in relation to the terms used to express the amounts of money that is pass on to or actually paid by customers. p. 1	Comments have been noted. The Draft Rule introduces a defined term to explain the amounts that would be recovered under the new cost recovery mechanism. The Commission considers clarity would be provided through the definition.
EnergyAustralia	Considers the proposed amendments to the AER's constituent decision on a DNSP's reporting requirements would not be necessary as the payments are an externally imposed obligation and not an input into the costs of providing distribution services. pp. 7-8. It notes that the AER's powers under the pricing process to consider whether it is satisfied forecasts provided are accurate. p. 8.	Given that DNSPs would be required to produce an annual forecast, which would require taking into consideration factors outside the control of DNSPs, the Commission considers that an AER decision on the reporting requirements should be included to provide clarity to the process. Additional discussion is outlined in chapter 6.
EnergyAustralia	Considers the proposed amendments to provide for variations to the determination if a feed-in scheme or climate change fund commences after a regulatory determination is unnecessary and overly complicated as a regulatory determination does not need to transgress into the reporting arrangements for recovery of payments made under these schemes. p. 8.	Comments have been noted. The Draft Rule clarifies the provisions for a new scheme coming into effect part way through a regulatory period. Additional discussion is outlined in chapter 7.

Stakeholder	Issue <sup>45</sup>	AEMC Response
Energex	Considers that the proposed clause 6.12.1(19A) could be redrafted to require a constituent decision at any time prior to the next regulatory control period. p. 2.	Comments have been noted. The Draft Rule clarifies the provisions for a new scheme coming into effect part way through a regulatory period. Additional discussion is outlined in chapter 7.
Energex	Considers that the proposed clause 6.12.1(19B) could be reconsidered to allow DNSPs to propose a methodology to adjust tariffs relating to distribution determinations made prior to the Rule coming into force.	Comments have been noted. The Draft Rule clarifies the provisions for a new scheme coming into effect part way through a regulatory period. Additional discussion is outlined in chapter 7.



## A.2 Second round of consultation

The second round of consultation on the Rule Change Request closed on 21 May 2010. In total, seven submissions were received. The issues raised in the submissions, and the AEMC's responses to these issues, are summarised in the following table.

Stakeholder	Issue <sup>46</sup>	AEMC Response
<b>Jurisdictional scheme - definition and criteria</b>		
DII	Considers that the definition of approved jurisdictional scheme should be amended to clarify that a jurisdictional scheme will continue to be covered by the Rule, even where there are subsequent legislative or regulatory amendments to the scheme.	The Rule as made requires that jurisdictional schemes would need to meet a set of defined criteria for the reasons as set out in chapter 7. As set out in section 7.3.2, if an approved jurisdictional scheme were amended, the DNSP would need to include relevant details in its pricing proposal.
DII	Notes that there may also be other enforceable obligations imposed on distribution network service providers in relation to the schemes (such as licence conditions imposed by the Minister and directions under the State Owned Corporations Act 1989) that should be considered part of the scheme for the purpose of the Rule. p. 1.	It is noted that under the definition of "jurisdictional scheme obligations" a DNSP's obligations, such as those under licence conditions, has been accounted for under the Rule as Made. This definition has been further clarified to include any directions made under the relevant Acts.
EnergyAustralia	EnergyAustralia agrees with the issues raised in DII's submission regarding definition of a jurisdictional scheme and the enforceable obligations imposed on DNSPs. p. 3.	As above.

<sup>46</sup> Page numbers refer to page numbers in the stakeholder's submission to the second round of consultation.

Stakeholder	Issue <sup>46</sup>	AEMC Response
EnergyAustralia	<p>Considers that the definition of "approved jurisdictional scheme" would not capture Climate Change Fund payments (where an approved jurisdictional scheme is defined as a jurisdictional scheme where the AER has approved the DNSP's reporting requirements). Considers that the proposed Rule should be amended/clarified to ensure that the applicable provisions, particularly in relation to the application of side constraints as discussed below, would apply to payments made under the Climate Change Fund. pp. 2-3.</p>	<p>As the Rule as Made introduces the new provision to allow NSW DNSPs to adjust for any over/under recovery for payments made under the Climate Change Fund, it is considered the DNSP should report on how such adjustments will be made. However, as the general provision for recovering the payments made under the Climate Change Fund is an existing provision under the Rules, any change that may affect existing obligations should be limited. For this reason the DNSP would need to advise how it will report to the AER in relation to the under/over recovery amounts in its next pricing proposal. This is discussed further in section 7.3.</p> <p>The intention under the Draft Rules were that the Climate Change Fund payments should be excluded from the side constraint calculation on tariffs for standard control services as the payment amounts are outside the control of DNSPs. The Rule as Made has been clarified.</p>
Integral Energy	<p>Although Integral Energy supports the draft Rule determination, it does not support the term "approved jurisdictional scheme" or the role of a regulator to determine whether schemes passed by State legislature are jurisdictional schemes. It proposes that the draft Rule be amended to clarify the role of the AER is to determine which mechanism is to be applied for the recovery of costs based on the elements of a jurisdictional scheme, rather than determine whether the scheme is a jurisdictional scheme under clause 6.18.7A(l). p. 1.</p>	<p>The defined term "approved jurisdictional scheme" in effect applies to schemes for which the payments made by DNSPs may be recovered through the proposed new cost recovery mechanism under the Rules.</p> <p>The jurisdictional scheme eligibility criteria for which the AER must consider in its consideration of whether a scheme would be a jurisdictional scheme is also defined under the Rule as Made. The role of the AER is to determine whether the scheme meets the criteria such that the new cost recovery mechanism may be applied, which the Commission considers is consistent with Integral Energy's submission.</p>

Stakeholder	Issue <sup>46</sup>	AEMC Response
AER	Considers that the approved jurisdictional scheme criteria should be amended to include the requirement that the intended allocation of costs is explicitly set out in the relevant jurisdictional scheme legislation. [This is related to the issue on the allocation of recovery amounts to tariff classes as discussed below]. p. 2.	As discussed in section 5.3.1, DNSPs should be provided with the opportunity to recover payments under these schemes in an efficient manner. Although it would be ideal that legislative provisions detailed how the cost recovery should be completed, where this is not the case, the DNSPs would be provided with a level of discretion.
CitiPower and Powercor	Notes that the draft Rule applies to obligations imposed under an Act or an order or instrument made under an Act of a participating jurisdiction. Proposes that the draft Rule should be amended to ensure that it can also apply to Acts of the Commonwealth. p. 4.	As the Rule as Made refers to obligations under "participating jurisdictions", Acts of the Commonwealth would be included as the Commonwealth is a participating jurisdiction by virtue of the Australian Energy Market Act 2004 of the Commonwealth.
Energex	Seeks confirmation that the scope of scheme obligations covered by the Draft Rule extends to those imposed under Commonwealth legislative instruments. p. 1.	As above.
CitiPower and Powercor	Notes that one of the requirements of the jurisdictional scheme eligibility criteria is that the amount is not in the nature of a fine, penalty or incentive payment. Notes that it should be clarified that the amount must not be an incentive for the DNSP. p. 4.	The Rule as Made has been clarified to set out that payments to be recovered would not include any incentive payments to DNSPs.
<b>Revocation and substitution of distribution determination for jurisdictional scheme recovery</b>		
Ergon Energy	Considers that the proposed drafting of the election process to recover jurisdictional scheme amounts under the Pricing Proposal is therefore unclear and circular. p. 2.	The Commission notes the points made by Ergon Energy. The Rule as Made sets out the steps that are to be followed and the Commission considers that they are relatively detailed. The required steps have been explained further in this Rule determination under section 3.2 to assist with clarifying the provisions and requirements.

Stakeholder	Issue <sup>46</sup>	AEMC Response
Ergon Energy	Is concerned that there is no positive obligation on the AER to issue a new distribution determination within a certain period of time. Recommends that the clause 6.18.7C(k) be amended to include a reasonable time period for the AER to make a revocation and substitution of the distribution determination. p. 2.	Given the circumstances of each DNSP may be different, the provisions under the Rule as Made provides flexibility to both the AER and the DNSP and are consistent with the existing provisions for the revocation and substitution of a distribution determination under the Rules. As clause 11.35.4(d) provides that the AER may only revoke and substitute a distribution determination if it has consulted with the relevant DNSP, it is considered that the provisions ensure the AER and the DNSP would be provided with the opportunity to discuss any individual requirements, including applicable timeframes where appropriate.
AER	Considers that the timeframe of 20 business days for the AER to assess an "election" by a DNSP to use the new cost recovery mechanism is inadequate. Notes that the AER may need to consider a revocation of existing determinations under this process. Considers that the 20 business day minimum window for notification of an election under clause 6.18.7(a) be extended to at least 40 days. p. 3.	The 20 business day timeframe applies to the formal election process under clause 11.35.2. As set out in section 3.2, the formal election cannot be made until the revocation and substitution (for which there is no specific time limit) has already taken place. For this reason, it is considered that a 20 business day timeframe at this stage of the process would be adequate.
Energex	Notes that the revocation and substitution of an existing distribution determination can be an onerous measure for the distribution business and the AER and, depending on the depth of amendment requirements, disproportionate to the relatively cursory process of adjusting for forecast scheme payments. The disincentive created may be considered as inconsistent with the National Electricity Objective of the efficient provision of electricity services. p. 2.	The revocation and substitution of a distribution determination is an optional process. Given that the circumstances may differ between DNSPs, each DNSP may assess whether it would like to elect to use the proposed new cost recovery provisions.

Stakeholder	Issue <sup>46</sup>	AEMC Response
Energex	<p>If the revocation and substitution requirement is to remain, a balanced approach that provides regulatory certainty for affected DNSPs might involve the AEMC and/or AER providing supplementary guidance as to:</p> <ul style="list-style-type: none"> <li>• Whether it would be sufficient for the revocation and substitution process to only involve the subtraction of the annual payment forecasts from the annual smoothed revenue requirement in the interests of administrative simplicity; and/or</li> <li>• How pass through application requirements under the Rules reconcile with the nature of eligible scheme payments.</li> </ul> <p>p. 2.</p>	<p>As noted above, the revocation and substitution requirement is an optional one and that circumstances may differ between DNSPs. In addition, the revocation and substitution provisions require the AER to consult with the DNSP in making its decision. It is considered that these provisions balances the interests of DNSPs and the AER.</p>
<b>Pricing proposal - process and provisions</b>		
EnergyAustralia	<p>Considers that the proposed Chapter 11 amendments may not achieve the AEMC's purpose to ensure that jurisdictional scheme payments are not subject to side constraint calculations. Proposes that the phrase "after the end of the first regulatory year" under proposed clauses 11.[.]2(h)(2) and 6.18.7C(f)(2) may be interpreted to suggest that jurisdictional payments are subject to side constraints limits in the first regulatory year to which a distributor is entitled to recover payments. If interpreted in this manner, there is a risk that side constraints will limit the ability of a distributor to recover its total revenue requirements for that regulatory year. p. 2.</p>	<p>The Rule as Made has been clarified.</p>

Stakeholder	Issue <sup>46</sup>	AEMC Response
AER	<p>Considers that the proposed Rule does not address whether controllable costs associated with administering a scheme would continue to be subject to review against the opex objective. In particular, the proposed Rule does not address whether such costs are to be treated as operating expenditure associated with the provision of standard control services, notwithstanding that such payments may be considered a regulatory obligation. p. 2.</p>	<p>As discussed in the draft Rule determination, it is considered that the administration costs would fall into costs required to comply with all applicable regulatory obligations or requirements associated with the provision of standard control services of the Rules. This final Rule determination provides additional clarification as set out in section 5.3.1. The Commission does not consider additional clarification under the Rules would be required at this time as the existing operating expenditure objectives under the Rules include costs required to comply with regulatory obligations.</p>
AER	<p>Notes that the proposed Rule does not indicate any criteria against which the AER would assess the proposed distribution of these costs, how the costs should be allocated amongst customers. In the absence of a jurisdictional scheme that sets out how costs are to be recovered, a DNSP would have broad scope under the NER to recover costs through its pricing proposal. p. 2.</p>	<p>It is considered that ideally the legislative scheme provisions should clarify how the costs should be recovered from each customer class. To the extent that a DNSP may have discretion in setting how costs are to be recovered, it would be required to ensure that it was meeting its obligations under the scheme.</p>
CitiPower and Powercor	<p>Notes that pricing proposals must be submitted approximately two months before the commencement of each regulatory year and, accordingly, it would not be possible to accurately determine the amount of any under or over recovery for the relevant preceding year as that year would be incomplete. Considers that the proposed Rule would not provide for accurate and effective true-up of previous payments unless the allowed adjustments was extended to include the year "t-2". p. 2.</p>	<p>The Commission acknowledges that accurate adjustments may be limited by restricting the adjustment of over/under recovery amounts to the preceding regulatory year. The Rule as Made has been clarified to permit the adjustment to be extended to take account of over/under recovery amounts from the previous two regulatory years.</p>

Stakeholder	Issue <sup>46</sup>	AEMC Response
CitiPower and Powercor	Considers that the proposed Rule does not account for the time value of money and the costs incurred by DNSPs as a result of the delay in receive any under recovery (or the benefit that is gained by DNSPs as a result of the delay in paying any over recovery). The amount of under or over recovery should be adjusted to account for inflation and the DNSP's nominal WACC. p. 2.	The Commission understands that, in practice, the AER would apply indexation to the over/under recovery amounts.
<b>Other issues</b>		
CitiPower and Powercor	Notes there appears to be a typographical error in the transitional provisions in clause 11.[.]2(b) of the draft Rule. The reference to 'the new clause 6.18.6(d)' should instead refer to 'the new clause 6.18.6.(d)(3)'.	The Rule as Made has been updated.