

23 September 2016

Mr John Pierce  
Chairman  
Australian Energy Market Commission  
SYDNEY SOUTH NSW 1235  
**Lodged online at [www.aemc.gov.au](http://www.aemc.gov.au)**

Dear Mr Pierce 

**Request for participant derogation to minimise pricing volatility following Tribunal determination**

We refer to the request for a participant derogation relating to each of the New South Wales distribution network service providers (**DNSPs**), Ausgrid, Endeavour Energy and Essential Energy (together, **NSW DNSPs**), to minimise pricing volatility following the decisions of the Australian Competition Tribunal (**Tribunal**) of 26 February 2016, received by the Australian Energy Market Commission (**AEMC**) on 18 July 2016 (AEMC reference ERC0210) (**NSW DNSPs' Request**).

As noted in the NSW DNSPs' Request, the circumstances giving rise to the potential pricing volatility that the NSW DNSPs' Request is intended to address also apply to ActewAGL Distribution (**ActewAGL**). Accordingly, included as **Attachment 1** to this letter is a request in accordance with section 91(5) of the National Electricity Law that the AEMC make a similar participant derogation relating to ActewAGL.

The proposed participant derogation relates to the operation of Chapter 6 of the National Electricity Rules (**NER**) and would be included in Chapter 8A. The draft participant derogation proposed by ActewAGL is included as **Attachment 2**.

ActewAGL's proposed participant derogation is designed to minimise price volatility for consumers in the Australian Capital Territory (**ACT**) while providing ActewAGL with a reasonable opportunity to recover at least its efficient costs of the period 1 July 2014 to 30 June 2019. There is a real chance that, following the conclusion of all review proceedings and further processes relating to the distribution determination for ActewAGL by the Australian Energy Regulator (**AER**) of 30 April 2015 (**2015 determination**), the AER will be required to remake the 2015 determination and this will result in a significant adjustment to ActewAGL's average annual revenue cap for distribution standard control services for the final year of the 2014-15 to 2018-19 regulatory period (**current regulatory period**). This is because, without a rule change, the final year of the current regulatory period may be the only year in which the remade determination can be reflected. This may in turn result in significant pricing volatility for electricity consumers in the ACT.

The proposed participant derogation addresses this potential price volatility by allowing for a portion of the differential in the total annual revenue requirements for distribution standard control services under the 2015 determination and the remade 2015 determination to be taken out of ActewAGL's smoothed revenue allowance for the current regulatory period and put into the building blocks for the subsequent regulatory control period to be recovered in that period. It does not alter the manner in which the NER operate to require the AER, in determining ActewAGL's revenue allowance in any remade determination during the current regulatory period, to adjust for any under or over recovery of revenue during that period relative to the re-determined revenue requirement amounts.

If the AER is required to remake the 2015 determination, there is a real chance that this will result in changes to ActewAGL's revenue allowances in respect of transmission standard control services and annual metering services, in addition to distribution standard control services. In circumstances where the AER does not remake the 2015 determination prior to the pricing proposal process for the final regulatory year of the current regulatory period, there is a risk that the NER could be interpreted in a way that would not permit any higher revenues from distribution standard control services, transmission standard control services or annual metering services arising from the remade 2015 determination to be recovered in the subsequent regulatory control period or lower revenues from those services to be returned to consumers (as the case may be). Accordingly, ActewAGL's proposed participant derogation provides for such revenue increments or decrements to be included in the relevant building blocks in the subsequent determination in order to provide ActewAGL with a reasonable opportunity to recover at least its efficient costs (as determined by the AER in the remade 2015 determination).

For the reasons outlined in Attachment 1, ActewAGL considers that the proposed participant derogation is the most preferable rule to contribute to the national electricity objective (**NEO**). It is also consistent with the revenue and pricing principles. In particular, as noted above, the proposed participant derogation minimises price shock for ACT consumers while providing ActewAGL with a reasonable opportunity to recover at least its efficient costs (as determined by the AER in the remade 2015 determination).

To the extent practicable given the differences between ActewAGL's 2015 determination and the determinations for the current regulatory period regarding the NSW DNSPs, the manner in which ActewAGL's proposed participant derogation operates to smooth revenues in respect of distribution standard control services between regulatory control periods is consistent with the NSW DNSPs' Request. Further details of the rationale for the proposed participant derogation and its operation are provided in the NSW DNSPs' Request, included as **Attachment 3** to this letter.

In addition, to assist the AEMC in considering this request, included as **Attachments 4 and 5** are:

- The draft participant derogation proposed by ActewAGL with amendments to the draft participant derogation proposed by the NSW DNSPs (Appendix 1 to the NSW DNSPs' Request) shown in mark-up.
- A table explaining the key amendments ActewAGL has made to the NSW DNSPs' draft participant derogation for the purposes of its proposed participant derogation.

If you have any queries regarding this request, please contact Patricia Cameron on (02) 6248 3812 or [patricia.cameron@actewagl.com.au](mailto:patricia.cameron@actewagl.com.au).

Yours sincerely,



Michael Costello  
Chief Executive Officer  
ActewAGL

## ATTACHMENT 1

### REQUEST FOR PARTICIPANT DEROGATION TO MINIMISE PRICING VOLATILITY FOLLOWING TRIBUNAL DETERMINATION

#### INTRODUCTION

- 1 ActewAGL Distribution (**ActewAGL**) is registered as a distribution network service provider (**DNSP**) under section 12(1) of the National Electricity Law (**NEL**) and clause 2.5.1 of the National Electricity Rules (**NER**) to own, control and operate the electricity distribution system located in the Australian Capital Territory (**ACT**). The NEL and the NER regulate the revenue that ActewAGL is permitted to derive from the provision of distribution services.
- 2 Pursuant to section 91(5) of the NEL, ActewAGL requests that the Australian Energy Market Commission (**AEMC**) make a participant derogation that relates to it to minimise pricing volatility in the coming regulatory years. The draft participant derogation proposed by ActewAGL is included as **Attachment 2**.
- 3 The request follows a similar request by Ausgrid, Endeavour Energy and Essential Energy (**NSW DNSPs**) received by the AEMC on 18 July 2016 (**NSW DNSPs' Request**). The request is made for the same reasons as the NSW DNSPs' Request. Further, in so far as is practicable given the differences between the Australian Energy Regulator's (**AER's**) distribution determination for ActewAGL of 30 April 2015 (**2015 determination**), and the AER's distribution determinations for the NSW DNSPs of 30 April 2015, the manner in which ActewAGL's proposed participant derogation operates to smooth revenues in respect of distribution standard control services between regulatory periods is consistent with the NSW DNSPs' Request.
- 4 The need for the rule change is brought about by a confluence of events which is unlikely to be repeated as described in section 4.5 of the NSW DNSPs' Request. The 2015 determination is currently the subject of judicial review proceedings initiated by the AER in the Full Federal Court. There is a real chance that, following the conclusion of all review proceedings and further processes relating to the 2015 determination, the AER will be required to remake the 2015 determination and this will result in a significant adjustment to ActewAGL's average annual revenue cap for the final year of the 2014-15 to 2018-19 regulatory period (**current regulatory period**). This is because, without a rule change, the final year of the current regulatory period may be the only year in which the remake determination can be reflected. This could in turn result in significant pricing volatility for electricity consumers in the ACT.
- 5 Similar to the NSW DNSPs' Request, ActewAGL's proposed participant derogation is designed to minimise price volatility for consumers in the ACT while providing ActewAGL with a reasonable opportunity to recover at least its efficient costs for the period 1 July 2014 to 30 June 2019.
- 6 The proposed participant derogation allows for a portion of the differential in the total annual revenue requirements in respect of distribution standard control services under the 2015 determination and the remake 2015 determination to be taken out of ActewAGL's smoothed revenue allowance for the current regulatory period and put into the building blocks for the subsequent regulatory control period to be recovered in that period. It does not alter the manner in which the NER operate to require the AER, in determining ActewAGL's revenue allowance in any remake determination during the current regulatory period, to adjust for any under or over recovery of revenue during that period relative to the re-determined revenue requirement amounts.

- 7 If the AER is required to remake the 2015 determination, there is real chance that this will also result in changes to ActewAGL's allowable revenues in respect of transmission standard control services and annual metering services (being the type 5 and 6 metering services classified as alternative control services and in respect of which annual metering service charges were specified in the 2015 determination).<sup>1</sup> In circumstances where the AER does not remake the 2015 determination prior to the pricing proposal process for the final regulatory year of the current regulatory period, there is a risk that the NER could be interpreted in a way that would not permit any higher revenues from distribution standard control services, transmission standard control services or annual metering services arising from the remade 2015 determination to be recovered in the subsequent regulatory control period. Accordingly, ActewAGL's proposed participant derogation provides for such revenue increments or decrements to be included in the relevant building blocks in the subsequent determination in order to provide ActewAGL with a reasonable opportunity to recover at least its efficient costs (as determined by the AER in the remade 2015 determination).
- 8 To assist the AEMC in considering this request, included as **Attachments 3 to 5** are:
- 8.1 a copy of the NSW DNSPs' Request;
  - 8.2 the draft participant derogation proposed by ActewAGL with the amendments to the draft participant derogation proposed by the NSW DNSPs (Appendix 1 to the NSW DNSPs' Request) shown in mark-up; and
  - 8.3 a table explaining the key amendments ActewAGL has made to the NSW DNSPs' draft participant derogation for the purposes of its proposed participant derogation.
- 9 Further details of the request, and the information required by section 92 of the NEL, are set out below.

## **PROPONENT**

- 10 The person making this request for a participant derogation is:

ActewAGL Distribution  
ActewAGL House, 40 Bunda Street, Canberra ACT 2600

## **STATEMENT OF ISSUE**

### **Background**

- 11 ActewAGL is registered as a DNSP under section 12(1) of the NEL and clause 2.5.1 of the NER to own, control and operate the electricity distribution system located in the ACT.
- 12 The NEL and the NER regulate the revenue that ActewAGL is permitted to derive from the provision of distribution services, as well as the process for setting the tariffs to recover that

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<sup>1</sup> AER, 2015 determination, pp. 16-21 to 16-55 and 16-61.

revenue. Broadly, the AER is required to make a distribution determination applicable to ActewAGL which is predicated on (among other things):

- 12.1 decisions on each of the building blocks for each year of the current regulatory period, which result in the annual revenue requirement for each year (and total revenue requirement for the period); and
  - 12.2 a decision on the form of the control mechanism (including the X factor) for standard control services and on the formula that give effect to that control mechanism.
- 13 Clause 6.5.9(3) of the NER provides that the X factor must be designed to equalise (in terms of net present value) the revenue to be earned by the DNSP from the provision of standard control services over the regulatory control period with the total revenue requirement for the regulatory control period. The X factor is the mechanism by which the AER is able to smooth the recovery of the total revenue requirement for a regulatory control period across the period (that is, rather than limiting the recovery of the annual revenue requirement for a given year to that year).
- 14 As a result of amendments made to the NER governing the economic regulation of DNSPs through the AEMC's *Rule Determination, National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012*, 29 November 2012, the AEMC deferred the full regulatory determination process for ActewAGL and the NSW DNSPs for the 2014-15 to 2018-19 regulatory control period. To allow for a transition to the new rules, the Savings and Transitional Rules in Division 2 of Part ZW of Chapter 11 of the NER provided for a two stage process for the regulation of ActewAGL and the NSW DNSPs over the five year period commencing on 1 July 2014 comprising:
- 14.1 the transitional regulatory control period, being 2014-15; and
  - 14.2 a further regulatory control period from 2015-16 to 2018-19.
- 15 As a result, the AER made a place holder distribution determination for ActewAGL for the transitional regulatory control period, 2014-15, on 16 April 2014.
- 16 On 30 April 2015, the AER then made a distribution determination for ActewAGL for the 2015-16 to 2018-19 period (i.e. the 2015 determination). The 2015 determination was to apply until 30 June 2019. This has the consequence that the period from the time of the making of the 2015 determination to the end of the regulatory control period is shorter than in the usual course.
- 17 ActewAGL has dual function assets, being high voltage transmission assets within its distribution network. The AER determined that the transmission pricing rules in Part J of Chapter 6 of the NER would apply to ActewAGL's dual function assets in the current regulatory period.<sup>2</sup> Accordingly, in accordance with clause 6.26 of the NER, in making the 2015 determination the AER divided the revenue calculated under Part C of Chapter 6 into a portion relevant to ActewAGL's transmission standard control services provided by its dual function assets and a portion relevant to the other standard control services provided by ActewAGL (i.e. its distribution standard control services). As such, in its 2015 determination, the AER determined annual revenue requirements in respect of each of

ActewAGL's distribution standard control services and its transmission standard control services.

- 18 The form of control applicable to ActewAGL's provision of distribution standard control services under the 2015 determination is an average revenue cap.<sup>3</sup> This differs from the form of control applicable to the NSW DNSPs' provision of standard control services being a revenue cap.
- 19 On 21 May 2015, ActewAGL applied to the Tribunal for review of its 2015 determination under section 71B of the NEL. On 26 February 2016, the Tribunal made a determination under section 71P of the NEL in respect of ActewAGL's application, which set aside the 2015 determination and remitted the matter back to the AER to make the determination again (**Tribunal's decision**). At the same time, the Tribunal made similar determinations in respect of applications for merits review by each of the NSW DNSPs.
- 20 In ActewAGL's case the Tribunal decided that the AER should remake the following constituent decisions in accordance with the Tribunal's reasons for decision:
- 20.1 operating expenditure;
  - 20.2 the service target performance incentive scheme (**STPIS**);
  - 20.3 return on debt in respect of the introduction of the trailing average approach; and
  - 20.4 estimated cost of corporate income tax (gamma).
- 21 In addition, the AER directed the AER to consider, and vary (to the extent to which it considers appropriate) the 2015 determination in such other respects as the AER considers appropriate having regard to section 16(1)(d) of the NEL in the light of such variations made to the 2015 determination by reason of the Tribunal's directions with respect to the constituent decisions referred to above.
- 22 On 24 March 2016, the AER applied for review of the Tribunal's decision (as well as the Tribunal's determinations regarding the NSW DNSPs) under the *Administrative Decisions (Judicial Review) Act 1977* (Cth) (**ADJR Application**). The AER has not sought, and the Federal Court has not made, an order suspending the operation of the Tribunal's decision pending the resolution of the AER's application. Possible outcomes of the Federal Court proceedings include the following:
- 22.1 The Court dismisses the AER's application. This would require the AER to remake the 2015 determination in accordance with the Tribunal's decision.
  - 22.2 The Court upholds in whole or in part the AER's application and refers the matter back to the Tribunal for further consideration. Following the Tribunal's further consideration of the matter, the AER may be required to remake the 2015 determination in accordance with a varied determination by the Tribunal.
- 23 The judicial review proceedings before the Federal Court and the remittal process before the AER have the result that there will be a delay in the AER remaking the 2015 determination. In order to ameliorate the uncertainty that delay would cause for users about applicable prices,

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<sup>3</sup> AER's 2015 determination, p. 14-6 (see also pp. 14-13 to 14-14).

on 16 May 2016, ActewAGL gave an undertaking to the AER under section 59A of the NEL which sets out its tariffs to be applied in the 2016-17 regulatory year (**section 59A undertaking**). Under the section 59A undertaking, ActewAGL's tariffs for network use of system (NUOS) services for 2016-17 have been set so that the applicable tariffs are ActewAGL's 2015-16 tariffs adjusted for changes in the Consumer Price Index (CPI).

### Nature and scope of issue

- 24 There is a real chance that the AER will be required to remake the 2015 determination either as a consequence of the Tribunal's decision or some future decision of the Tribunal that is made in accordance with the orders of the Full Federal Court in the ADJR Application. While the timing for the AER's remaking of the 2015 determination is unknown, it is likely that the remade determination will not be in place until after pricing for the penultimate year of the current regulatory period is set.
- 25 If the AER is required to remake the 2015 determination, this could result in a significant increase or decrease in ActewAGL's revenue allowance in the current regulatory period. ActewAGL's NUOS charges for 2015-16 were set on the basis of the 2015 determination, while its NUOS charges for 2016-17 were set on the basis of the section 59A undertaking.
- 26 In respect of distribution and transmission standard control services in remaking the 2015 determination in the current regulatory period, the AER will determine the smoothed or expected revenue for the remaining year(s) of that period having regard to the net over or under recovery in previous years of the current regulatory period associated with revenue differentials under the 2015 determination and the remade 2015 determination; and the section 59A undertaking and the remade determination. This will occur through the determination of the X factor which will be applied to the annual revenue requirements determined by the AER in respect of distribution and transmission standard control services in the remade 2015 determination in order to determine the smoothed or expected revenue for the remaining year(s) of the current regulatory period.
- 27 In circumstances where the remade determination is not in place until pricing for the penultimate year of the current regulatory period is set, under the applicable NER provisions this would mean that the remade determination could only impact on prices in the final year of the current regulatory period. This is because:
  - 27.1 The X factors must be designed to equalise (in terms of net present value) the revenue to be earned by ActewAGL from the provision of standard control services over the current regulatory period with the total revenue requirement for the regulatory control period.
  - 27.2 The X factors (and thus ActewAGL's revenue) in years 1 to 4 of the current regulatory period could not be adjusted by reference to the total revenue requirement in the remade determination - the tariffs in those years would already have been set.
  - 27.3 In the event the allowable revenue in the remade determination differed significantly from the revenue applicable under the 2015 determination and pricing specified in the section 59A undertaking, in the absence of the proposed participant derogation, the AER would be required to provide for ActewAGL to recover (or return to consumers) the full impact of the remade determination in the final year of the current regulatory period by adjusting the X factor (and resultant tariffs) for that year to achieve this. This will have the result that the smoothed or expected revenue for that year determined under the 2015 remade

determination is significantly higher (or lower) than the revenue allowance applicable in the previous year, which in turn results in a higher (or lower) average annual revenue cap and  $MAR_t$  in that year for ActewAGL.

- 28 The AER adopts a similar smoothing approach in determining the form of control for metering. As such the revenue impact of the 2015 remade determination would also be expected to be reflected in the smoothed or expected revenues determined by the AER for use in establishing, and thus also reflected in, the control mechanism for annual metering services in the remaining years of the current regulatory period.
- 29 In the absence of the adjustment to ActewAGL's average annual revenue cap for distribution standard control services contemplated by the rule change, this could give rise to significant price shock for consumers in the ACT.
- 30 The potential for price shock in the absence of a rule change is described diagrammatically in Figure 1 in section 3.3 of Attachment 1 of NSW DNSPs' Request. In addition, in section 3.3.1 of Attachment 1 of the NSW DNSPs' Request the NSW DNSPs provide illustrative examples of revenue changes in the absence of a rule change. Those examples apply similarly to ActewAGL (assuming that consumption for the current regulatory period and subsequent regulatory control periods is as forecast).
- 31 As noted above, the Tribunal's decision contemplates that there could be a change in ActewAGL's STPIS in the remade 2015 determination. Under the average revenue cap control mechanism applicable to ActewAGL's distribution standard control services, for the purpose of its pricing proposals ActewAGL's average annual smoothed revenue in year  $t$  is adjusted by an  $S_t$  factor being the STPIS factor sum of the raw  $s$ -factors for reliability of supply and customer service parameters (as applicable) to be applied in year  $t$ .<sup>4</sup> In the absence of a rule change there is no clear mechanism under the NER to account for any change to ActewAGL's STPIS as a result of the remade 2015 determination.
- 32 In addition, the NER do not clearly permit any higher or lower revenues (as applicable) from distribution standard control services, transmission standard control services or annual metering services arising from the remade 2015 determination to be recovered (or returned to customers) in the subsequent regulatory control period. Accordingly, in the absence of a rule change there is no clear mechanism under the NER for such revenues to be recovered (or returned to customers) in circumstances where the AER does not remake its 2015 determination until after the pricing proposal process for the final regulatory year of the current regulatory period.

### **How the proposed participant derogation addresses the issue**

- 33 The proposed participant derogation has been prepared to address the pricing impact of any higher revenues arising from the remade 2015 determination taking effect in the final year of the current regulatory period by allowing for a portion of the differential in the total annual revenue requirements for distribution standard control services under the 2015 determination and the remade 2015 determination to be taken out of ActewAGL's smoothed revenue allowance for the final year of the current regulatory period and put into the building blocks for the subsequent regulatory control period to be recovered in that period.

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AER, 2015 determination, p. 14-14.

- 34 Under the proposed participant derogation, adjustments to minimise price variation in respect of NUOS charges between regulatory years and regulatory control periods occur through the annual pricing proposal process for the current regulatory period and by an adjustment to the building blocks in the distribution determination for the subsequent regulatory control period.
- 35 The derogation also provides for an adjustment to be made to allow for the recovery/imposition of the difference between the  $S_t$  factor (STPIS factor) under the 2015 determination and the remade 2015 determination. This is because, as noted above, the Tribunal's decision contemplates that there could be a change in ActewAGL's STPIS in the remade 2015 determination.
- 36 In circumstances where the AER remakes its 2015 determination prior to 1 March of the penultimate regulatory year of the current regulatory period, the proposed participant derogation operates as follows:
- 36.1 the AER determines an adjustment amount based on the differential between the annual revenue requirements for distribution standard control services in the remade 2015 determination and the 2015 determination;
  - 36.2 recovery of the adjustment amount is smoothed across the remaining years of the current regulatory period and the subsequent regulatory control period;
  - 36.3 in the current regulatory period, the portion of the adjustment amount to be recovered in the subsequent regulatory control period is accounted for in the annual pricing proposal process; and
  - 36.4 in the subsequent regulatory control period, the portion of the adjustment amount that was not recovered in the current regulatory period is included as a revenue increment (if positive) or decrement (if negative) in the building blocks determined under clause 6.4 of the NER for the first year of the subsequent regulatory control period.
- 37 In circumstances where the AER remakes its 2015 determination prior to 1 March of the penultimate regulatory year of the current regulatory period, the AER also determines an adjustment amount based on the differential between the  $S_t$  factor between the remade 2015 determination and the 2015 determination. That adjustment amount will be recovered by ActewAGL (in the case of a positive value) as an increase to ActewAGL's average annual revenue cap, or imposed as a penalty on ActewAGL (in the case of a negative value) as a reduction to ActewAGL's average annual revenue cap in the remaining regulatory years of the current regulatory period through the annual pricing proposal process.
- 38 In addition, in circumstances where the AER does not remake the 2015 determination until on or after 1 March of the penultimate regulatory year of the current regulatory period, the proposed participant derogation allows for the recovery, or bringing to account, of any higher or lower revenues from transmission standard control services or annual metering services from the remade 2015 determination in the subsequent regulatory control period.
- 39 In circumstances where the AER does not remake the 2015 determination until on or after 1 March of the penultimate regulatory year of the current regulatory period, the proposed participant derogation provides for the following to occur in the subsequent determination:
- 39.1 adjustment amounts in respect of the differentials between ActewAGL's allowable revenue for distribution and transmission standard control services under the remade 2015 determination and the 2015 determination to be included

- in the building blocks determined under clause 6.4 of the NER for the first year of the subsequent regulatory control period; and
- 39.2 the adjustment amount in respect of the differential between ActewAGL's allowable revenue for annual metering services under the remade 2015 determination and the 2015 determination to be included in the building block revenue requirements for annual metering services for the first year of the subsequent regulatory control period.
- 40 As described below, the proposed participant derogation also applies in circumstances where the AER does not remake the 2015 determination.
- 41 The proposed participant derogation does not alter the rules applying to the AER's calculation of ActewAGL's annual revenue requirements or smoothed revenue in respect of distribution standard control services in the remade 2015 determination. Rather, it alters the profile for the recovery of that revenue. The proposed participant derogation enables ActewAGL to recover (or return to consumers) the impact of the remade 2015 determination in any remaining year(s) of the current regulatory period and the subsequent regulatory control period. By allowing the revenue impact to be recovered (or returned to consumers) over a longer period, the proposed participant derogation reduces the potential pricing volatility for consumers.
- 42 Further detail regarding how the proposed participant derogation resolves the issue of potential pricing volatility for consumers as a result of changes to revenue allowances in respect of distribution standard control services between the 2015 determination and remade 2015 determination is set out in section 4.2 of Attachment 1 of the NSW DNSPs' Request. The illustrative examples provided by the NSW DNSPs in Figures 6 and 7 apply similarly to ActewAGL (assuming that consumption for the current and subsequent regulatory control periods is as forecast).
- 43 ActewAGL's proposed participant derogation does not provide for the smoothing of any higher or lower revenues from transmission standard control services or annual metering services from the remade 2015 determination between the current regulatory period and the subsequent regulatory control period. This is because:
- 43.1 ActewAGL considers that the ability to vary the annual distribution adjustment amount discussed below should provide sufficient flexibility to address any price volatility in overall NUOS charges that may otherwise arise from the recovery of the revenue impact of the remade 2015 determination in respect of transmission standard control services in the final year of the current regulatory period; and
- 43.2 unlike with respect to distribution standard control services revenue, ActewAGL does not expect the revenue impact of the remade 2015 determination in respect of annual metering services to be significant such that it will cause price volatility if it is only recovered in the final year of the current regulatory period, should the AER remake the 2015 determination prior to 1 March of the penultimate regulatory year of the current regulatory period.
- 44 The operation of ActewAGL's proposed participant derogation is described in further detail below.

## **NER do not address this issue**

- 45 As discussed on pages 24 to 25 of the NSW DNSPs' Request, the current NER do not address the issue that is the subject of the proposed participant derogation.
- 46 The NER do not clearly permit any higher or lower revenues in respect of distribution standard control services or transmission standard control services arising from the remade 2015 determination to be recovered in the following regulatory control period as a result of the NER requirements for the setting of X factors in the remade 2015 determination.
- 47 To enable the recovery of higher or lower revenues (as applicable) in the following regulatory control period, the AER would have to set X factors that result in smoothed revenues for the regulatory period, the total of which is less than (or more than) the total revenue requirement for that period. Clause 6.5.9 of the NER does not permit the AER to set such an X factor. Further, clause 6.5.9 requires the X factors to be set so as to smooth the total revenue requirement for a regulatory control period within that regulatory control period.
- 48 While clause 6.4.3(a)(6) and (b)(6) of the NER provide for revenue increments or decrements arising from the application of a control mechanism in the previous regulatory control period to be carried forward and included in the building blocks for the subsequent regulatory control period, this would not apply to permit ActewAGL to recover a portion of any higher or lower revenues (as applicable) arising from the remade 2015 determination because there would be no revenue increments or decrements arising from the application of ActewAGL's control mechanism. Rather, the NER provides for the higher or lower revenues arising from the remade 2015 determination to be recovered in the remaining year(s) of the current regulatory period.
- 49 The current rules are unlikely to assist the AER in managing the pricing volatility in the remaining year(s) of the current regulatory period because prices generally must be set to recover allowed revenues.
- 50 Further, in the absence of a rule change there is no clear mechanism under the NER to account for any change to ActewAGL's STPIS as a result of the remade 2015 determination.
- 51 In addition, the NER do not clearly provide for any higher or lower revenues in respect of distribution standard control services, transmission standard control services or annual metering services from the remade 2015 determination to be recovered in the subsequent regulatory control period.

## **Participant derogation more appropriate than wider rule change**

- 52 In section 4.5 of Attachment 1 of the NSW DNSPs' Request, the NSW DNSPs describe why the present circumstances suggest that a rule change applying to them is more appropriate than a wider rule change that would apply to all DNSPs. The NSW DNSPs note in section 4.5 that the particular circumstances necessitating their proposed rule change only apply to them and ActewAGL.
- 53 Having regard to the matters set out in section 4.5 of Attachment 1 of the NSW DNSPs' Request and for the reasons set out therein, ActewAGL considers that it is appropriate that the participant derogation proposed by ActewAGL only apply to it, rather than there be a wider rule change applying to all DNSPs.

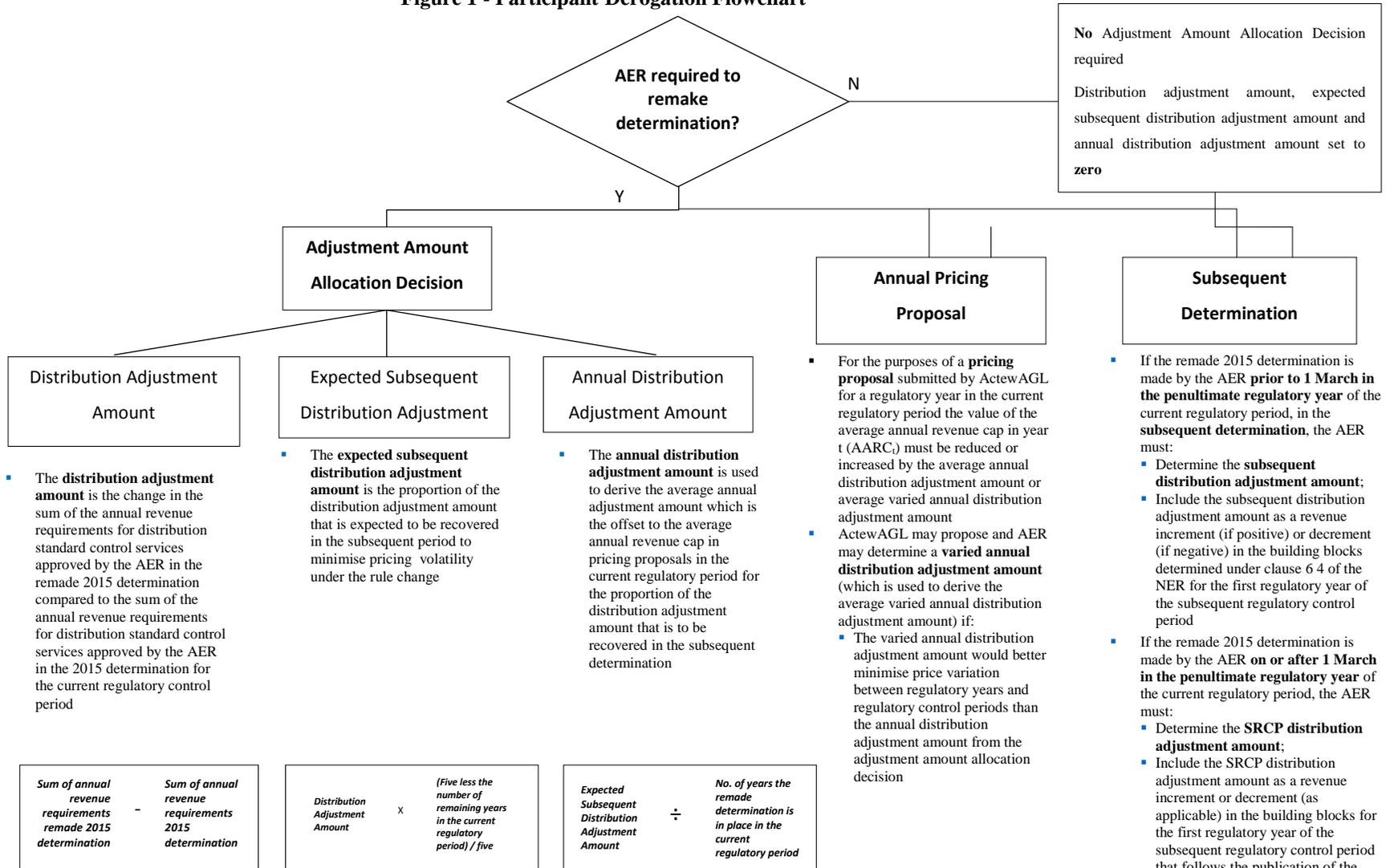
## DESCRIPTION OF PROPOSED PARTICIPANT DEROGATION

- 54 The draft participant derogation provided with this request (Attachment 2) sets out proposed new rules to be included in Chapter 8A of the NER.
- 55 ActewAGL's proposed participant derogation operates with respect to allowable revenue for distribution standard control services in a similar manner to that of the NSW DNSPs as described in section 4 of Attachment 1 to the NSW DNSPs' Request. However, as explained in the table in Attachment 5, ActewAGL has made changes to the NSW DNSPs' draft derogation having regard to the different form of control applicable to ActewAGL, to address revenue recovery with respect to transmission standard control services and annual metering services and to account for any change to ActewAGL's STPIS as a result of the remade 2015 determination.
- 56 Similar to the NSW DNSPs' Request, ActewAGL's proposed participant derogation operates in circumstances where the remade 2015 determination is made by the AER whether prior to 1 March 2018 (2017/18 being the penultimate regulatory year of the current regulatory period) or on or after that date. In addition, as described below, the proposed participant derogation still has application if the AER ceases to be under an obligation to remake the 2015 determination, as may be the case if the AER is successful in the ADJR Application.
- 57 In circumstances where the remade 2015 determination is made by the AER prior to 1 March 2018, ActewAGL's participant derogation requires the following steps:
- 57.1 **Step 1** - determine the adjustment amount in respect of distribution standard control services and the allocation of this amount between regulatory control periods and the adjustment amount in respect of the  $S_t$  factor;
- 57.2 **Step 2** - make an adjustment to revenues recovered in the current regulatory period via the pricing proposal process to account for the portion of the adjustment amount for distribution standard control services revenue to be recovered in the subsequent regulatory control period and the portion of the adjustment amount for that year in respect of the  $S_t$  factor; and
- 57.3 **Step 3** - make any required adjustments in the subsequent regulatory control period via the building block process to recover the remaining proportion of any adjustment amount for distribution standard control services in that period.
- 58 A further description of these steps is provided below.
- 59 In circumstances where the remade 2015 determination is made by the AER on or after 1 March 2018, ActewAGL's proposed participant derogation requires the following steps:
- 59.1 **Step 1** - determine the adjustment amounts in respect distribution standard control services, annual metering services and transmission standard control services;
- 59.2 **Step 2** - make any required adjustments in the subsequent regulatory control period control via the building block process to recover the full adjustment amounts in that period. In the case of the adjustments for distribution standard control services and transmission standard control services this occurs via the determination of the building blocks under clause 6.4 of the NER. In the case of the adjustment for annual metering services, this occurs in the calculation of the

building block revenue requirement for those services that is used by the AER in establishing the individual price caps applicable to those services.

- 60 A flowchart setting out the operation of the proposed participant derogation with respect to revenue for distribution standard control services only is provided in Figure 1 overleaf. This flowchart is based on the flowchart in Figure 4 of Attachment 1 to the NSW DNSPs' Request, however, has been amended having regard to the differences in ActewAGL's proposed participant derogation.

**Figure 1 - Participant Derogation Flowchart**



**Recovery of revenue if the remade 2015 determination is made by the AER prior to 1 March of the penultimate regulatory year of the current regulatory period**

*Step 1 - Determine the adjustment amount and the allocation between regulatory control periods*

- 61 In circumstances where the remade 2015 determination is made by the AER prior to 1 March of the penultimate regulatory year of the current regulatory period, at the time of remaking the 2015 determination, the AER is required to determine the following for ActewAGL:
- 61.1 the adjustment amounts in respect of distribution standard control services (**distribution adjustment amount**) and the  $S_t$  factor ( **$S_t$  adjustment amount**);
  - 61.2 the expected subsequent distribution adjustment amount (being the proportion of the distribution adjustment amount that it is expected will be recovered by ActewAGL in the subsequent regulatory control period); and
  - 61.3 the annual distribution adjustment amount and annual  $S_t$  adjustment amount for each remaining year of the current regulatory period.
- 62 Under the proposed participant derogation, the expected subsequent distribution adjustment amount and the annual distribution adjustment amount are calculated on the basis that the adjustment amount will be allocated equally over five regulatory years. This is consistent with the usual five year regulatory control period and incentive elements contained in the regulatory framework. However, in the current regulatory period, this position can be varied through the annual pricing proposal process in order to minimise pricing volatility should the circumstances warrant. Further, since the subsequent distribution adjustment amount is included in the building blocks in the subsequent regulatory control period, the AER has flexibility, in determining the X factors and associated smoothed revenues for that period in accordance with clause 6.5.9 of the NER, to determine the profile of the recovery of that portion of the adjustment amount over that regulatory control period.
- 63 The annual  $S_t$  adjustment amount under the proposed participant derogation is the  $S_t$  adjustment amount divided by the number of remaining regulatory years in the current regulatory period.
- 64 The steps which the AER is required to undertake in making the adjustment amount allocation determination under ActewAGL's proposed derogation are similar to those described on pages 11 to 13 of Attachment 1 of the NSW DNSPs' Request, except that ActewAGL's proposed derogation allows for an adjustment for STPIS.<sup>5</sup>
- 65 In summary, the steps the AER would be required to take under ActewAGL's proposed derogation in preparing its adjustment amount allocation determination are as follows:
- 65.1 **Determine the distribution adjustment amount** - this represents the aggregate change in net present value terms in the sum of the annual revenue requirements for distribution standard control services approved by the AER in the remade 2015 determination compared to the sum of the annual revenue requirements approved by the AER in the 2015 determination for the current regulatory period.

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<sup>5</sup> Note that the NSW DNSPs' Request refers to the AER's determination of the annual adjustment amount in describing Step 2. Since the determination of ActewAGL's analogous annual distribution adjustment amount is also part of the adjustment amount allocation determination ActewAGL has included it in describing Step 1 for completeness.

- 65.2 **Determine the expected subsequent distribution adjustment amount** - this represents the proportion of the distribution adjustment amount included in the AER's remade 2015 determination that would be recovered in the remaining regulatory year(s) of the current regulatory period in the absence of a rule change, but that is targeted to be recovered in the subsequent regulatory control period to minimise pricing volatility under the proposed participant derogation. It is based on the default position being determined by dividing the distribution adjustment amount by 5 and allocating 1/5 to each year of the 5 year allocation period starting from the year the remade 2015 determination is reflected in pricing. For example, if the remade 2015 determination governs pricing for the last year of the current regulatory period, the expected subsequent distribution adjustment amount would be based on 4/5, or 80%, of the distribution adjustment amount being recovered in the subsequent regulatory control period and 1/5, or 20%, of the distribution adjustment amount being recovered in the current regulatory period.
- 65.3 **Determine the annual distribution adjustment amount** for each remaining regulatory year of the current regulatory period. The annual distribution adjustment amount is equivalent in net present value terms to the expected subsequent distribution adjustment amount divided by the number of remaining regulatory years in the current regulatory period.
- 65.4 **Determine the  $S_t$  adjustment amount** - this represents the aggregate change in STPIS reward or penalty under the remade 2015 determination compared to the STPIS reward or penalty under the 2015 determination/section 59A undertaking (excluding the transitional regulatory control period). The transitional regulatory control period is excluded since the STPIS did not apply to ActewAGL in the transitional regulatory control period.<sup>6</sup> Since the  $S_t$  factor for 2015-16 was set at zero under the 2015 determination and the  $S_t$  factor implicit in pricing under the section 59A undertaking was therefore also zero,<sup>7</sup> this results in the relevant adjustment being equal to the sum of the product of the  $S_t$  factor under the remade 2015 determination and forecast demand in the 2015 determination for each regulatory year in which there was no pricing proposal that gave effect to the remade 2015 determination. For the years where there is a pricing proposal which gives effect to the remade 2015 determination, the STPIS reward/penalty will be calculated in accordance with that remade determination.
- 65.5 **Determine the annual  $S_t$  adjustment amount** for each remaining regulatory year of the current regulatory period. The annual  $S_t$  adjustment amount is equivalent in net present value terms to the  $S_t$  adjustment amount divided by the number of remaining regulatory years in the current regulatory period.
- 66 The allocation of the expected subsequent distribution adjustment amount from the current regulatory period to the subsequent regulatory control period takes place via the pricing proposal process described in Step 2 below. The recovery of the subsequent distribution

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<sup>6</sup> AER, Ausgrid, Endeavour Energy, Essential Energy and ActewAGL, Transitional distribution decision 2014-15, April 2014, p. 49.

<sup>7</sup> The 2015 determination provides that the  $S_t$  factors for 2015-16 and 2016-17 are set at zero (AER, 2015 determination, p. 14-14). Since the section 59A undertaking applied to ActewAGL's tariffs for 2016-17 and the applicable NUOS tariffs under that undertaking were ActewAGL's 2015-16 NUOS tariffs adjusted for CPI, the  $S_t$  factor implicit in ActewAGL's pricing under the section 59A undertaking is zero.

adjustment amount in the subsequent regulatory control period takes place via the building block process in the subsequent determination described in Step 3 below.

- 67 As noted above, in circumstances where the AER remakes the 2015 determination prior to 1 March 2018, the  $S_t$  adjustment amount is only accounted for in the current regulatory period - its recovery/imposition is not smoothed into the subsequent regulatory control period. This is because, unlike the distribution adjustment amount, ActewAGL does not expect the amount to be significant such that it will cause price volatility if it is only recovered/imposed in the final year of the current regulatory period. Further, the ability to vary the annual distribution adjustment amount discussed below should provide sufficient flexibility to address any price volatility in overall NUOS charges arising from the application of the  $S_t$  adjustment amount in the current regulatory period.

*Step 2 - Make adjustments to revenues through pricing proposal process*

- 68 The second step under the derogation involves making an adjustment to revenues recovered in the current regulatory period via the pricing proposal process to account for the portion of the distribution adjustment amount to be recovered in the subsequent regulatory control period.

- 69 In the pricing proposal process ActewAGL may propose and the AER may revise (with or without a proposed variation from ActewAGL) an annual distribution adjustment amount that is different from the annual distribution adjustment amount determined by the AER in its adjustment amount allocation determination under Step 1 if the varied annual distribution adjustment amount would better minimise price variation between regulatory years and regulatory control periods than the annual distribution adjustment amount (**varied annual distribution adjustment amount**).

- 70 Since ActewAGL operates under an average revenue cap form of control, under ActewAGL's proposed participant derogation, the adjustment to ActewAGL's control mechanism in the current regulatory period to provide for the proportion of the distribution adjustment amount that is to be recovered in the subsequent regulatory control period is made by making an adjustment to ActewAGL's average annual revenue cap in year  $t$  ( $AARC_t$ ). Consequently, it is necessary to make that adjustment by adjusting the average annual revenue cap in year  $t$  ( $AARC_t$ ) for the average annual distribution adjustment amount or average varied distribution annual adjustment amount.

- 71 Under the proposed participant derogation, the average annual distribution adjustment amount is determined by averaging the annual distribution adjustment amount across forecast demand for the relevant regulatory year in the remade 2015 determination. Similarly, the average varied annual distribution adjustment amount is determined by averaging the varied annual distribution adjustment amount across forecast demand for the relevant regulatory year.

- 72 In order to account for changes in the STPIS between the 2015 determination and the remade 2015 determination, the derogation also provides for an adjustment to be made to the average annual revenue cap in year  $t$  ( $AARC_t$ ) for the annual  $S_t$  adjustment amount for the relevant regulatory year. ActewAGL has not provided for a varied annual  $S_t$  adjustment amount process in the derogation. ActewAGL observes that the ability to vary the annual distribution adjustment amounts should provide sufficient flexibility to address any price volatility in NUOS charges that might otherwise arise from the inclusion of the annual  $S_t$  adjustment amount without variation.

- 73 Accordingly, ActewAGL's proposed participant derogation provides that for the purposes of a pricing proposal submitted by ActewAGL for a regulatory year in the current regulatory period the value of the average annual revenue cap in year  $t$  ( $AARC_t$ ) must be:

- 73.1 reduced or increased by the average distribution annual adjustment amount or average varied distribution adjustment amount for that regulatory year (where that amount is positive or negative respectively); and
- 73.2 reduced or increased by the annual  $S_t$  adjustment amount for that regulatory year (where that amount is negative or positive respectively).
- 74 The proposed participant derogation also makes some consequential changes to the operation of certain of the pricing proposal provisions in Part I of Chapter 6 of the NER.
- 75 For the avoidance of doubt, the proposed participant derogation provides for adjustments to the pricing proposals to be made only in the current regulatory period. It does not provide for adjustments to pricing proposals to be made in the subsequent regulatory control period, but rather the proportion of the distribution adjustment amount which was not recovered in the current regulatory period is included as a revenue increment (if positive) or decrement (if negative) in the building blocks determined under clause 6.4 of the NER for the first year of the subsequent regulatory control period. The AER can then determine the profile of the recovery of that portion of the distribution adjustment amount over the subsequent regulatory control period in determining the X factors and associated smoothed revenues for that period in accordance with clause 6.5.9 of the NER.

*Step 3 - Include the subsequent distribution adjustment amount in the subsequent determination*

- 76 Under Step 3 of the proposed participant derogation process, in the subsequent determination, the AER is required to:
- 76.1 determine the subsequent distribution adjustment amount (being the portion of the distribution adjustment amount that was not recovered in the current regulatory period); and
- 76.2 include the subsequent distribution adjustment amount as a revenue increment (if positive) or decrement (if negative) in the building blocks determined under clause 6.4 of the NER for the first regulatory year of the subsequent regulatory control period.
- 77 The subsequent distribution adjustment amount is the sum of all annual distribution adjustment amounts or varied annual distribution adjustment amounts that were used to derive the average annual distribution adjustment amounts or average varied annual distribution adjustment amounts for the purposes of the adjustments to the average annual revenue cap made through the pricing proposal process described in Step 2. This is because, as noted above, the adjustments to the average annual revenue cap under Step 2 were made in order to account for the portion of the distribution adjustment amount to be recovered in the subsequent regulatory control period.
- 78 The subsequent distribution adjustment amount may or may not be equal to the expected subsequent distribution adjustment amount as determined by the AER in the adjustment amount allocation determination. That is, the two amounts would be equal (subject to any present value adjustments) unless a varied annual distribution adjustment amount was applied in a pricing proposal(s) in the current regulatory period.

- 79 As noted above, including the subsequent distribution adjustment amount as a revenue increment or decrement in the building blocks in the subsequent determination<sup>8</sup> provides the AER with the flexibility to determine the profile of the recovery of that portion of the adjustment amount over the subsequent regulatory control period in determining the X factors and associated smoothed revenues for that period in accordance with clause 6.5.9 of the NER, and to address potential price shocks within that period.
- 80 The determination by the AER of the subsequent distribution adjustment amount is taken to be a constituent decision for the purposes of clause 6.12.1 of the NER.

*Varied annual distribution adjustment amount*

- 81 As noted under Step 2 above, in the pricing proposal process ActewAGL may propose and the AER may revise (with or without a proposed variation from ActewAGL) a varied annual distribution adjustment amount that better minimises price variation between regulatory years and regulatory control periods than the annual distribution adjustment amount determined by the AER in the adjustment amount allocation determination.
- 82 The AER must accept the varied annual distribution adjustment amount proposed by ActewAGL if it is satisfied that the proposed varied annual distribution adjustment amount would better minimise price variation between regulatory years and regulatory control periods for ActewAGL's customers than the annual distribution adjustment amount for that regulatory year set out in the adjustment amount allocation determination. If the AER is not satisfied that the varied annual distribution adjustment amount would better minimise pricing volatility, it is not required to accept ActewAGL's proposed variation.
- 83 In proposing or revising a varied annual distribution adjustment amount, ActewAGL or the AER (as applicable) needs to take into account:
- 83.1 the change in the revenue allowance for distribution standard control services between the fourth and fifth regulatory years of the current regulatory period as a result of the remade 2015 determination;
  - 83.2 the known and forecast revenues recovered or to be recovered by ActewAGL at the time of the remade 2015 determination; and
  - 83.3 any other relevant factor.
- 84 Since the annual distribution adjustment amount is based on the differential between the annual revenue requirements for distribution standard control services in the 2015 determination and the remade 2015 determination, rather than actual or expected revenues recovered in the lead up to the remade 2015 determination and there is no smoothing of the  $S_t$  adjustment amount or revenue impact of the remade 2015 determination for transmission standard control services, it may be that there is another annual distribution adjustment amount which better minimises price volatility in tariffs for distribution standard control services or overall NUOS charges for ActewAGL's customers.
- 85 As discussed below, if the AER ceases to be under an obligation to remake the 2015 determination, the annual distribution adjustment amount is deemed to be zero, however, ActewAGL is still able to propose and the AER may revise (with or without a proposed

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<sup>8</sup> To be indexed by the appropriate discount rate to determine net present value.

variation from ActewAGL) a varied annual distribution adjustment amount if it would better minimise pricing volatility taking into account the matters set out above.

#### **If the AER ceases to be under an obligation to remake the 2015 determination**

- 86 The proposed participant derogation also applies if the AER ceases to be under an obligation to remake the 2015 determination. This situation could arise if the Full Federal Court finds in favour of the AER in its ADJR Application or if the Tribunal is required to remake its decision and in doing so finds that there are no grounds for review and that the AER's 2015 determination should be reinstated.
- 87 In circumstances where the AER is not required to remake the 2015 determination, the proposed derogation provides that all of the adjustment amounts in respect of distribution standard control services and the  $S_i$  factor are deemed to be zero.
- 88 However, if the AER is not required to remake the 2015 determination, ActewAGL can propose in the pricing proposal process for a regulatory year of the current regulatory period and the AER may revise (with or without a proposed variation from ActewAGL) a varied annual distribution adjustment amount if it would better minimise pricing volatility. In those circumstances, the proposed participant derogation still provides for the smoothing of revenues across regulatory control periods to minimise pricing volatility that might arise, for example, having regard to pricing pursuant to section 59A undertakings prior to it being known that the AER was not required to remake the 2015 determination.

#### **Recovery of revenue if the remade 2015 determination is made by the AER on or after 1 March of the penultimate regulatory year of the current regulatory period**

- 89 The proposed participant derogation also applies if the remade 2015 determination is made by the AER on or after 1 March of the penultimate regulatory year of the current regulatory period.
- 90 If the AER is required to remake the 2015 determination, there is real chance that this will also result in changes to ActewAGL's allowable revenues in respect of transmission standard control services and annual metering services. In circumstances where the AER does not remake the 2015 determination prior to the pricing proposal process for the final regulatory year of the current regulatory period, the NER do not clearly permit any higher or lower revenues (as applicable) from distribution standard control services, transmission standard control services or annual metering services arising from the remade 2015 determination to be recovered in the subsequent regulatory control period. Accordingly, ActewAGL's proposed participant derogation provides for such revenue increments or decrements to be included in the relevant building blocks in the subsequent determination in order to provide ActewAGL with a reasonable opportunity to recover at least its efficient costs (as determined by the AER in the remade 2015 determination).
- 91 In circumstances where the remade decision is made after 1 March 2018, the proposed participant derogation provides that:
- 91.1 at the time of making the remade 2015 determination, the AER must determine the SRCP distribution adjustment amount, the transmission adjustment amount and the metering adjustment amount;
  - 91.2 the AER must make or remake the subsequent determination (as applicable) so that:

- 91.2.1 the SRCP distribution adjustment amount and transmission adjustment amount are included as revenue increments (if positive) or decrements (if negative) in the building blocks determined under clause 6.4 of the NER for the first regulatory year of the subsequent regulatory control period that follows the publication of the remade 2015 determination; and
  - 91.2.2 the metering adjustment amount is included as a revenue increment (if positive) or decrement (if negative) in the building block revenue requirement for annual metering services for the first regulatory year of the subsequent regulatory control period that follows the publication of the remade 2015 determination; and
  - 91.3 the determination of each of the SRCP distribution adjustment amount, transmission adjustment amount and the metering adjustment amount is taken to be a constituent decision for the purposes of clause 6.12.1 of Chapter 6 of the NER.
- 92 With respect to distribution standard control services, in order to place ActewAGL, to the extent possible having regard to its form of control, in the position it would have been in with respect to allowable revenue if the remade 2015 determination had applied throughout the current regulatory period, the proposed participant derogation provides for the SRCP distribution adjustment amount to be calculated as the sum of the difference for each regulatory year of the current regulatory period between (1) the value of the average annual revenue cap (AARC<sub>t</sub>) calculated in accordance with the remade 2015 determination, multiplied by the forecast demand for the relevant regulatory year as set out in the 2015 determination; and (2) the value of the average annual revenue cap (AARC<sub>t</sub>) calculated in accordance with the 2015 determination, multiplied by the forecast demand for the relevant regulatory year as set out in the 2015 determination. This is consistent with ActewAGL's form of control in the current regulatory period pursuant to which ActewAGL, and not consumers, bears the demand risk. This calculation would also account for any differentials in ActewAGL's STPIS rewards/penalties between the remade 2015 determination and the 2015 determination.
- 93 With respect to transmission standard control services, in order to place ActewAGL (to the extent possible) in the position it would have been in with respect to allowable revenue if the remade 2015 determination had applied throughout the current regulatory period, the proposed participant derogation provides for the transmission adjustment amount to be calculated as the sum of the difference for each regulatory year of the current regulatory period (excluding the transitional regulatory control period) between (1) the value of the MAR<sub>t</sub> for transmission standard control services calculated in accordance with the remade 2015 determination; and (2) the value of the MAR<sub>t</sub> for transmission standard control services calculated in accordance with the 2015 determination. The transitional regulatory control period is excluded from this calculation because ActewAGL's MAR for the 2015-16 to 2018-19 regulatory control period will have already been adjusted for the difference between the annual revenue requirement for transmission standard control services approved for the transitional regulatory control period in the AER's placeholder distribution determination for that period<sup>9</sup> and the notional annual revenue requirement for the transitional regulatory

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AER, Ausgrid Endeavour Energy Essential Energy ActewAGL, Transitional distribution decision 2014–15, April 2014, pp. 29-32.

control period determined in the remade 2015 determination under clause 11.56.4(h) and (i) of the NEL.

- 94 The metering adjustment amount is the sum of (1) the building block revenue requirement for annual metering services for each regulatory year of the current regulatory period set out in or derived for the purpose of the remade 2015 determination; and (2) the building block revenue requirement for annual metering services for each regulatory year of the current regulatory period set out in or derived for the purpose of the 2015 determination.

### **Expiry**

- 95 The participant derogation is proposed to expire at the end of the subsequent regulatory control period.

### **CONTRIBUTION TO THE ACHIEVEMENT OF THE NEO**

- 96 Under the NEL, the AEMC may only make the proposed participant derogation if it is satisfied that it will or is likely to contribute to achievement of the NEO (section 88 of the NEL). The AEMC may give such weight to any aspect of the NEO as it considers appropriate in all the circumstances, having regard to any relevant MCE statement of policy principles.
- 97 The AEMC must also take into account the revenue and pricing principles in the NEL in making the proposed participant derogation as it relates to distribution system revenue and pricing or regulatory economic methodologies (section 88B and items 25 to 26J of Schedule I of the NEL).
- 98 ActewAGL's proposed participant derogation will contribute to the achievement of the NEO taking into account the revenue and pricing principles for the same reasons as the NSW DNSPs' Request sets out in section 5 of Attachment 1 of that Request. In summary, the proposed participant derogation will contribute to the achievement of the NEO as follows:
- 98.1 **minimises price shocks** - the proposed participant derogation is designed to minimise price shocks for ACT consumers by smoothing the recovery of differentials in revenue requirements in respect of distribution standard control services under the 2015 determination and remade 2015 determination over the remaining year(s) of the current regulatory period and the subsequent regulatory control period. The lessening of price shocks and associated greater pricing stability ensures electricity consumers are given balanced incentives relating to the use of electricity services, consistent with the NEO. Any short term variations in price as a consequence of the remade 2015 determination would not be caused by increases in cost and are likely to lead to inefficient use of electricity and inefficient investment in alternative means of supply or generation, which is contrary to the NEO;
- 98.2 **ActewAGL can recover the revenue that reflects its efficient and prudent costs and best promotes the achievement of the NEO** - the proposed participant derogation allows ActewAGL to recover the revenue it is entitled to collect arising from the remade 2015 determination. The Tribunal set aside the 2015 determination on the basis that it was satisfied that to do so would or would be likely to result in a decision that is materially preferable to the 2015 determination in making a contribution to the achievement of the NEO (section

71P(2a)(c)). The AER is required to remake the 2015 determination in a manner that will or is likely to contribute to the achievement of the NEO (section 16(1)(a) of the NEL). Further, in remaking the 2015 determination, if there are two or more possible reviewable regulatory decisions, the AER is required to make the decision that will or is likely to contribute to the achievement of the NEO to the greatest degree (section 16(1)(d) of the NEL). It follows that the remade 2015 determination will contribute to the achievement of the NEO. It further follows that allowing ActewAGL to recover any differential in revenues in respect of distribution standard control services, transmission standard control services and annual metering services, in addition to any differential in ActewAGL's STPIS rewards/penalties, between the 2015 determination and the remade 2015 determination contributes to the achievement of the NEO;

- 98.3 **certainty** - the proposed participant derogation provides certainty over both the likely increase in allowable revenue that may occur year-on-year which will flow through to customer pricing through clause 6.18 of the NER and the ability of ActewAGL to recover the revenue it is entitled to recover following the AER's remade 2015 determination. The increase in regulatory certainty will substantially improve the regulatory regime for consumers and ActewAGL by enabling ActewAGL to invest efficiently in, and consumers to efficiently use, electricity services having regard to the AER's remade 2015 determination;
- 98.4 **minimises administration costs** - as described in the NSW DNSPs' Request there are limited administration costs from the proposed participant derogation as it does not create entirely new regulatory processes, but rather the provisions of the derogation can be given effect to as part of processes that would already occur, including the remaking of the 2015 determination, the pricing proposal process and the subsequent determination. There would be no administration costs to other DNSPs associated with the application of the participant derogation;
- 98.5 **revenues set above or below efficient levels** - the consequence of the AER remaking its 2015 determination late in the current regulatory period is that in the absence of the proposed participant derogation allowable revenues for the remaining year(s) of that period will be set above (or below) efficient levels. Further, while the derogation seeks to minimise price volatility in those years, it will remain the case that allowable revenues for those years will be set above (or below) efficient levels. The derogation also has the consequence that allowable revenues in the subsequent regulatory control period will be set above (or below) efficient levels. This has the potential to impact on customer's usage decisions - with higher prices potentially resulting in inefficient lower utilisation of the network and metering services and lower prices potentially resulting in inefficient increased utilisation (depending on consumers' responsiveness to price signals). For the reasons set out in the NSW DNSPs' Request, ActewAGL considers that the proposed participant derogation strikes an appropriate balance between the objectives of minimising pricing volatility and the setting of efficient prices to create price signals for economic usage decisions.

## EXPECTED BENEFITS AND COSTS, AND POTENTIAL IMPACTS

- 99 The expected benefits of the proposed derogation are summarised above by reference to the NSW DNSPs' Request. In particular, the proposed participant derogation contributes to the

NEO by ensuring that ActewAGL can recover the revenue that it is entitled to while also minimising price shock for ACT consumers.

- 100 The administrative costs of achieving these benefits are limited because the requirements on the AER in the proposed participant derogation are incorporated within regulatory processes already required by the NER or that will be required as a result of the Court's or Tribunal's decision in respect of the 2015 determination - for example, the remaking of the 2015 determination, the annual pricing proposal process and the making of the subsequent determination.
- 101 Due to the adoption of a participant derogation, the potential impact of the rule change is confined insofar as practicable while addressing the issues of concern being the potential for price shocks for ACT consumers and the ability for ActewAGL to recover its efficient and prudent costs.

## ATTACHMENT 2

### ActewAGL Distribution's proposed participant derogation

#### Part 15 Derogation granted to ActewAGL Distribution

##### 8A.15 Derogation to provide for price smoothing and address revenue recovery following the Australian Competition Tribunal's decision

###### 8A.15.1 Overview

- (a) This *participant derogation*, rule 8A.15, provides for:
- (1) the smoothing of the recovery by ActewAGL Distribution of the difference between its *annual revenue requirements* in respect of distribution standard control services for each *regulatory year* in the current regulatory period set out in:
    - A. the 2015 determination; and
    - B. the remade 2015 determination,with such adjustments as may be necessary to best minimise price variation between *regulatory years* and *regulatory control periods*;
  - (2) the recovery or imposition of the revenue attributable to the difference between the  $S_t$  factor applicable under the 2015 determination in each of the *regulatory years* of current regulatory period (excluding the transitional regulatory control period) for which there was no pricing proposal that gave effect to the remade 2015 determination and that applicable under the remade 2015 determination; and
  - (3) the AER ceasing to be under an obligation to remake the 2015 determination, the smoothing of the recovery of the *annual revenue requirements* set out in the 2015 determination.
- (b) If the remade 2015 determination is made by the AER prior to 1 March of the penultimate *regulatory year* of the current regulatory period or the AER ceases to be under an obligation to make the remade 2015 determination, then:
- (1) clause 8A.15.3 will apply; and
  - (2) the smoothing of revenue referred to in clause 8A.15.1(a) will be over:
    - A. each remaining *regulatory year* of the current regulatory period; and
    - B. the subsequent regulatory control period.
- (c) If the remade 2015 determination is made by the AER on or after 1 March of the penultimate *regulatory year* of the current regulatory period, then:
- (1) clause 8A.15.4 will apply;
  - (2) this *participant derogation* provides for the recovery over the subsequent regulatory control period only of:

- A. the difference between expected revenues in respect of distribution standard control services calculated in accordance with the remade 2015 determination and the 2015 determination derived on the basis of the average annual revenue cap in the remade 2015 determination and forecast demand in the 2015 determination;
- B. the difference between allowed revenues in respect of *transmission standard control services* calculated in accordance with the remade 2015 determination and the 2015 determination; and
- C. the difference between the building block revenue requirements for annual metering services set out in, or derived for the purpose of the remade 2015 determination and the 2015 determination.

(d) Definitions for this *participant derogation* are set out in clause 8A.15.5.

#### **8A.15.2 Expiry**

This *participant derogation* expires at the end of the subsequent regulatory control period.

#### **8A.15.3 Recovery of revenue in the current regulatory period and subsequent regulatory control period**

##### **General**

- (a) This clause 8A.15.3 applies if:
  - (1) the remade 2015 determination is made by the AER prior to 1 March of the penultimate *regulatory year* of the current regulatory period; or
  - (2) the AER ceases to be under an obligation to make the remade 2015 determination.

##### **Determination of adjustments**

- (b) At the time of making the remade 2015 determination, the AER must make an adjustment amount allocation determination for ActewAGL Distribution that satisfies the requirements of clause 8A.15.3(c).
- (c) The adjustment amount allocation determination must determine the following for ActewAGL Distribution:
  - (1) the distribution adjustment amount;
  - (2) the expected subsequent distribution adjustment amount;
  - (3) the annual distribution adjustment amount for each remaining *regulatory year* of the current regulatory;
  - (4) the  $S_t$  adjustment amount; and
  - (5) the annual  $S_t$  adjustment amount for each remaining *regulatory year* of the current regulatory period.
- (d) If the AER ceases to be under an obligation to remake the 2015 determination for ActewAGL Distribution, then:

- (1) for the avoidance of doubt, the AER is not under an obligation to make an adjustment amount allocation determination for ActewAGL Distribution; and
- (2) each of the adjustment amounts referred to in clause 8A.15.3(c) are deemed to be zero for the purposes of this clause 8A.15.3.

**Recovery in the current regulatory period**

- (e) For the purposes of a pricing proposal submitted by ActewAGL Distribution for a *regulatory year* in the current regulatory period the value of the average annual revenue cap in year  $t$  ( $AARC_t$ ) must be:
  - (1) reduced or increased by the average annual distribution adjustment amount or average varied annual distribution adjustment amount determined in accordance with clause 8A.15.3(g) for that *regulatory year* (where that amount is positive or negative respectively); and
  - (2) reduced or increased by the annual  $S_t$  adjustment amount for that *regulatory year* (where that amount is negative or positive respectively).
- (f) ActewAGL Distribution may propose in a pricing proposal for a *regulatory year* in the current regulatory period an annual distribution adjustment amount for that *regulatory year* that is different from:
  - (1) the annual distribution adjustment amount determined by the AER in its adjustment amount allocation determination; or
  - (2) the deemed annual distribution adjustment amount under clause 8A.15.3(d)(2),  
(as applicable) if the proposed annual distribution adjustment amount would better minimise price variation between *regulatory years* and *regulatory control periods* than the annual distribution adjustment amount referred to in subclauses (1) or (2) taking into account:
    - (3) the change in the revenue allowance for distribution standard control services between the fourth and fifth *regulatory years* of the current regulatory period ending on 30 June 2018 and 30 June 2019 respectively as a result of the remade 2015 determination;
    - (4) the known and forecast revenues recovered or to be recovered by ActewAGL Distribution at the time of the remade 2015 determination; and
    - (5) any other relevant factor.
- (g) In determining whether to approve a pricing proposal for ActewAGL Distribution for a *regulatory year* in the current regulatory period under clause 6.18, the AER:
  - (1) must accept the annual distribution adjustment amount proposed by ActewAGL Distribution under clause 8A.15.3(f) if it is satisfied that the proposed annual distribution adjustment amount would better minimise price variation between *regulatory years* and *regulatory control periods* for ActewAGL Distribution's customers than the annual distribution adjustment amount for that *regulatory year* set out in the adjustment amount allocation determination or the deemed annual distribution adjustment amount under clause 8A.15.3(d)(2) (as applicable);

- (2) may revise the annual distribution adjustment amount proposed by ActewAGL Distribution under clause 8A.15.3(f) if it is satisfied that the revised adjustment amount would better minimise price variation between *regulatory years* and *regulatory control periods* for ActewAGL Distribution's customers than:
- A. the annual distribution adjustment amount proposed by ActewAGL Distribution; and
  - B. either the annual distribution adjustment amount for that *regulatory year* set out in the adjustment amount allocation determination or the deemed annual distribution adjustment amount under clause 8A.15.3(d)(2) (as applicable); and
- (3) may revise the annual distribution adjustment amount if ActewAGL Distribution has not proposed an adjustment amount under clause 8A.15.3(f) and the AER is satisfied that a revised adjustment amount would better minimise price variation between *regulatory years* and *regulatory control periods* for ActewAGL Distribution's customers than the annual distribution adjustment amount for that *regulatory year* set out in the adjustment amount allocation determination or the deemed annual distribution adjustment amount under clause 8A.15.3(d)(2) (as applicable),

taking into account the factors specified in clause 8A.15.3(f)(3) to (5).

- (h) For the purposes of clauses 8A.15.3(e), 8A.15.3(f) and 8A.15.3(g), Chapter 6 is amended for the remainder of the current regulatory period as follows:
- (1) ActewAGL Distribution is not required to comply with clause 6.18.1A(c) or 6.18.1C to the extent necessary to allow the reduction or increase of the average annual revenue cap ( $AARC_t$ ) in accordance with clause 8A.15.3(e) by the average annual distribution adjustment amount for a *regulatory year* or the average varied annual distribution adjustment amount for a *regulatory year* (as applicable), and the annual  $S_t$  adjustment amount;
  - (2) the reference to 'any applicable distribution determination' in clauses 6.18.2(b)(7), 6.18.2(b)(8), 6.18.8(a)(1) and 6.18.8(c) will be interpreted to mean the remade 2015 determination as adjusted in accordance with clause 8A.15.3(e) by the average annual distribution adjustment amount for each *regulatory year* or the average varied annual distribution adjustment amount (as applicable), and the annual  $S_t$  adjustment amount;
  - (3) the change to the average annual revenue cap ( $AARC_t$ ) in accordance with clause 8A.15.3(e) by the average annual distribution adjustment amount for a *regulatory year* or the average varied annual distribution adjustment amount for a *regulatory year* (as applicable) and the annual  $S_t$  adjustment amount is a permitted variation from the pricing principles set out in clauses 6.18.5(e) to 6.18.5(j);
  - (4) clause 6.18.6 does not apply;
  - (5) any variation in proposed tariffs caused by the remade 2015 determination and the change to the average annual revenue cap ( $AARC_t$ ) by the average annual distribution adjustment amount or the average varied annual distribution adjustment amount (as applicable) and the annual  $S_t$  adjustment amount will be

deemed to be explained by this derogation for the purposes of clause 6.18.8(a)(2); and

- (6) if the AER amends a pricing proposal pursuant to clause 6.18.8(b)(2) or 6.18.8(c), then in addition to the requirements in clause 6.18.8(c1), the AER must have regard to:
- A. any variation in proposed tariffs caused by the remade 2015 determination;
  - B. the change to the average annual revenue cap (AARC<sub>t</sub>) by the average annual distribution adjustment amount or the average varied annual distribution adjustment amount (as applicable) and the annual S<sub>t</sub> adjustment amount pursuant to this derogation; and
  - C. whether the average annual distribution adjustment amount or the average varied annual distribution adjustment amount (as applicable) in the amended pricing proposal better minimises price variation between *regulatory years* and *regulatory control periods* relative to the pricing proposal submitted by ActewAGL Distribution,

and all references in the Rules to the clauses of the Rules referred to in (h)(1) to (6) above must be interpreted as references to those provisions as amended by this clause 8A.15.3(h).

- (i) If the remade 2015 determination is *published* on or after 1 March of the penultimate *regulatory year* of the current regulatory period, that remade 2015 determination must be disregarded in applying the provisions of Part I of Chapter 6 as it applies in the current regulatory period.

#### **Recovery in the subsequent regulatory control period**

- (j) Except as otherwise set out in this clause 8A.15.3, Chapter 6 (other than clause 6.5.9(b)(2)) governs the making of the subsequent determination for ActewAGL Distribution.
- (k) In each subsequent determination, the AER must:
- (1) determine the subsequent distribution adjustment amount for ActewAGL Distribution; and
  - (2) include the subsequent distribution adjustment amount as a revenue increment (if positive) or decrement (if negative) in the building blocks determined under clause 6.4 for the first *regulatory year* of the subsequent regulatory control period.
- (l) The determination by the AER of the subsequent distribution adjustment amount under clause 8A.15.3(k)(1) is taken to be a constituent decision for the purposes of clause 6.12.1 of Chapter 6.

#### **8A.15.4 Recovery of revenue in the subsequent regulatory control period only**

##### **General**

- (a) This clause 8A.15.4 applies if the remade 2015 determination is made by the AER on or after 1 March of the penultimate *regulatory year* of the current regulatory period.

##### **Determination of the adjustment**

- (b) The AER must:

- (1) at the time of making the remade 2015 determination for ActewAGL Distribution, determine the SRCP distribution adjustment amount, the transmission adjustment amount and the metering adjustment amount; and
  - (2) make or remake the subsequent determination (as applicable) for ActewAGL Distribution in accordance with clauses 8A.15.4(d) and 8A.15.4(e).
- (c) The determinations by the AER of the SRCP distribution adjustment amount, the transmission adjustment amount and the metering adjustment amount under clause 8A.15.4(b)(1) are taken to be constituent decisions for the purposes of clause 6.12.1 of Chapter 6.

#### **Recovery in the subsequent regulatory control period**

- (d) Except as otherwise set out in this clause 8A.15.4, Chapter 6 (other than clause 6.5.9(b)(2)) governs the making or remaking of the subsequent determination for ActewAGL Distribution.
- (e) In the subsequent determination or remade subsequent determination (as applicable), the AER must:
- (1) include the SRCP distribution adjustment amount and the transmission adjustment amount as revenue increments (if positive) or decrements (if negative) in the building blocks determined under clause 6.4 for the first *regulatory year* of the subsequent regulatory control period that follows the publication of the remade 2015 determination; and
  - (2) include the metering adjustment amount as a revenue increment (if positive) or decrement (if negative) in the building block revenue requirement for annual metering services for the first *regulatory year* of the subsequent regulatory control period that follows the publication of the remade 2015 determination.

#### **8A.15.5 Definitions**

In this *participant derogation*, rule 8A.15:

**2015 determination** means the distribution determination for the current regulatory period published by the AER on 30 April 2015 in respect of ActewAGL Distribution.

**ActewAGL Distribution** means the *Registered Participant* that is registered by AEMO as a *Network Service Provider* in accordance with section 12(1) of the *National Electricity Law* and clause 2.5.1 of the *Rules* to own, control and operate the electricity distribution system located in the Australian Capital Territory.

**adjustment amount allocation determination** means the determination made by the AER in accordance with clause 8A.15.3(b).

**annual distribution adjustment amount** means the amount for each *regulatory year* remaining in the current regulatory period that is equivalent in net present value terms to:

- (a) the expected subsequent distribution adjustment amount; divided by
- (b) the number of remaining *regulatory years* in the current regulatory period.

**annual metering services** means the type 5 and 6 metering services classified as alternative control services, and in respect of which annual metering service charges were specified in the 2015 determination.

**annual  $S_t$  adjustment amount** means the amount for each *regulatory year* remaining in the current regulatory period that is equivalent in net present value terms to:

- (a) the  $S_t$  adjustment amount; divided by
- (b) the number of remaining *regulatory years* in the current regulatory period.

**average annual distribution adjustment amount** means, in respect of a *regulatory year* of the current regulatory period, the annual distribution adjustment amount divided by the forecast total kWh for that *regulatory year* in the remade 2015 determination.

**average varied annual distribution adjustment amount** means, in respect of a *regulatory year* of the current regulatory period, the varied annual distribution adjustment amount divided by the forecast total kWh for that *regulatory year* in the remade 2015 determination.

**current regulatory period** means the regulatory period of five years that commenced on 1 July 2014 and ends on 30 June 2019, which includes the 'transitional regulatory control period' and 'subsequent regulatory control period' as those terms are defined in clause 11.55.1 of the *Rules*.

**distribution adjustment amount** means:

- (a) the sum of the *annual revenue requirements* for distribution standard control services approved by the AER in the remade 2015 determination for each *regulatory year* of the current regulatory period; less
- (b) the sum of the *annual revenue requirements* for distribution standard control services approved by the AER in the 2015 determination for each *regulatory year* of the current regulatory period,

subject to such modifications as are necessary to ensure that:

- (c) the sum of the amount referred to in paragraph (b) of this definition and the distribution adjustment amount,

is equivalent in net present value terms to:

- (d) the amount referred to in paragraph (a) of this definition.

**distribution standard control services** means *standard control services* other than *transmission standard control services*.

**expected subsequent distribution adjustment amount** means the amount that it is equivalent in net present value terms to:

- (a) the distribution adjustment amount; multiplied by
- (b) the factor determined as follows:
  - (1) five less the number of remaining *regulatory years* in the current regulatory period; divided by
  - (2) five.

**metering adjustment amount** means:

- (a) the sum of the building block revenue requirements for annual metering services for each *regulatory year* of the current regulatory period set out in or derived for the purpose of the remade 2015 determination; less

- (b) the sum of the building block revenue requirements for annual metering services for each *regulatory year* of the current regulatory period set out in or derived for the purpose of the 2015 determination,

subject to such modifications as are necessary to ensure that:

- (c) the sum of the amount referred to in paragraph (b) of this definition and the metering adjustment amount,

is equivalent in net present value terms to:

- (d) the amount referred to in paragraph (a) of this definition.

**remade 2015 determination** means the 2015 determination of ActewAGL Distribution as remade by the AER following the Tribunal's decision.

**S<sub>t</sub> adjustment amount** means the amount that is equivalent in net present value terms to the sum of:

- (a) the S<sub>t</sub> factor calculated in accordance with the remade 2015 determination; multiplied by  
(b) the forecast total kWh as set out in the 2015 determination,

for each of the *regulatory years* of the current regulatory period (excluding the transitional regulatory control period) for which there was no pricing proposal that gave effect to the remade 2015 determination.

**SRCP distribution adjustment amount** means:

- (a) the sum of:

- (1) the value of the average annual revenue cap (AARC<sub>t</sub>) calculated in accordance with the remade 2015 determination; multiplied by  
(2) the forecast total kWh as set out in the 2015 determination,

for each *regulatory year* of the current regulatory period (excluding the transitional regulatory control period); less

- (b) the sum of:

- (1) the value of the average annual revenue cap (AARC<sub>t</sub>) calculated in accordance with the 2015 determination; multiplied by  
(2) the forecast total kWh as set out in the 2015 determination,

for each *regulatory year* of the current regulatory period (excluding the transitional regulatory control period),

subject to such modifications as are necessary to ensure that:

- (c) the sum of the amount referred to in paragraph (b) of this definition and the SRCP distribution adjustment amount,

is equivalent in net present value terms to:

- (d) the amount referred to in paragraph (a) of this definition.

**subsequent distribution adjustment amount** means the amount that is equivalent in net present value terms to the sum of the annual distribution adjustment amounts and/or varied annual distribution adjustment amounts (as applicable) for each relevant *regulatory year* in the current regulatory period.

**subsequent determination** means ActewAGL Distribution's distribution determination for the subsequent regulatory control period made by the AER.

**subsequent regulatory control period** means the *regulatory control period* for ActewAGL Distribution that immediately follows the current regulatory period.

**transitional regulatory control period** has the meaning in clause 11.55.1 of the *Rules* being a period of one year that commences on 1 July 2014 and ends on 30 June 2015.

**transmission adjustment amount** means:

- (a) the sum of the value of the  $MAR_t$  for *transmission standard control services* for each *regulatory year* of the current regulatory period (excluding the transitional regulatory control period) calculated in accordance with the remade 2015 determination; less
- (b) the sum of the value of the  $MAR_t$  for *transmission standard control services* for each *regulatory year* of the current regulatory period (excluding the transitional regulatory control period) calculated in accordance with the 2015 determination,

subject to such modifications as are necessary to ensure that:

- (c) the sum of the amount referred to in paragraph (b) of this definition and the transmission adjustment amount,

is equivalent in net present value terms to:

- (d) the amount referred to in paragraph (a) of this definition.

**Tribunal's decision** means the decision of the Australian Competition Tribunal in relation to ActewAGL Distribution's 2015 determination delivered on 26 February 2016, as varied or remade as a consequence of a decision of the Federal Court or Australian Competition Tribunal applying the outcome of the judicial review of the Australian Competition Tribunal's decision delivered on 26 February 2016.

**varied annual distribution adjustment amount** means an annual distribution adjustment amount accepted or revised by the AER in accordance with clause 8A.15.3(g).

# ATTACHMENT 3

## REQUEST FOR A RULE CHANGE

### Relating to

### Derogation for the current regulatory control period and subsequent regulatory control period to minimise pricing volatility following the Australian Competition Tribunal's decision

#### 1 Introduction

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This document is a proposal to change the National Electricity Rules (**NER** or **Rules**). The proponents of this proposal are Ausgrid, Endeavour Energy and Essential Energy (each a **NSW DNSP**), each of which is:

- A 'Registered Participant' within the National Electricity Market (**NEM**); and
- A 'Distribution Network Service Provider' (**DNSP**) that engages in the activity of operating a distribution system in New South Wales.

As Distribution Network Service Providers, the revenue and pricing of the NSW DNSPs are regulated by Chapters 6 and 6B of the NER.

On 26 February 2016, the Australian Competition Tribunal (**Tribunal**) made a decision on the merits review applications of the NSW DNSPs (and other third parties) (**Decision**), which set aside the distribution determinations made by the Australian Energy Regulator (**AER**) in 2015 for each of the NSW DNSPs (each a **2015 determination**) and remitted them to the AER.

The AER has sought reviews in the Full Federal Court of the Tribunal's Decisions under the *Administrative Decisions (Judicial Review) Act 1977* (Cth) (**ADJR Act**) (**ADJR Applications**). The AER has not sought an interim order in the Full Federal Court that the Tribunal's Decisions be stayed pending the hearing of the ADJR Applications. The possible outcomes of the ADJR Applications include that the Full Federal Court: dismisses the ADJR Applications on the AER; or upholds in whole or in part the ADJR applications of the AER and the matters be referred back to the Tribunal for further consideration, subject to such directions as the court thinks fit.

In May 2016, the NSW DNSPs gave undertakings to the AER under section 59A of the National Electricity Law to regulate prices in the year 1 July 2016 to 30 June 2017 (**Section 59A Undertakings**). As a consequence of the section 59A undertakings, the NSW DNSPs are recovering revenues greater than those provided for in the 2015 determinations.

This application is made to the AEMC on the basis that there is a real chance that:

- (a) The AER will be required to remake the 2015 determinations either as a consequence of the Tribunal's Decisions or as a consequence of some future Tribunal decisions that are made in accordance with orders of the Full Federal Court in the ADJR Applications and consumers will experience a price shock in the last year of the current regulatory period; or
- (b) The AER will not be required to remake the 2015 determinations as a consequence of some future Tribunal decisions that are made in accordance with orders of the Full Federal Court in the ADJR Applications and consumers will experience a price shock in the fifth year of the current regulatory control

period as a consequence of the application of the bringing of the “unders and over account” provided for to a zero balance in the last year of the current regulatory period in accordance with Attachment 14 to the AER’s 2015 determinations (constituent decision dealing with the control mechanism).

The consequence of the AER remaking the 2015 determinations (each a **remade 2015 determination**) in accordance with the directions in the Tribunal’s Decision is the potential for there to be a significant adjustment in total revenue requirements (**adjustment amount**) for the current regulatory control period that commenced on 1 July 2014 and will end on 30 June 2019 (**current regulatory control period**).

In the absence of a rule change, any adjustment amount (positive or negative) must be recovered in the current regulatory control period, which may lead to significant pricing volatility for NSW consumers given the limited time left to recover the adjustment amount in the current regulatory control period following the AER’s remade 2015 determinations. The rule change would therefore enable a specified portion of the adjustment amount to be recovered over two regulatory control periods, with a specified “default” allocation of the adjustment amount being recovered in the subsequent regulatory control period commencing 1 July 2019 (**subsequent regulatory control period**).

In addition, the actual or forecast revenues recovered by the NSW DNSPs in the regulatory years of the current regulatory control period in the lead-up to the remade 2015 determinations (assumed to be Years 1 to 4) will necessarily impact on the annual revenue requirement for Year 5 as determined by the AER in the remade 2015 determination (**annual revenue requirement** or **ARR**) given the AER’s requirement as set out in each 2015 determination to ensure the sum of the five annual revenue requirements equate to the building block allowances for the current regulatory control period (in net present value terms).

In the absence of a rule change, it is unclear whether any change in the annual revenue requirement in the last year of the current regulatory control period that leads to significant network price volatility can be managed by spreading the revenue impacts over a longer period. The proposed rule change includes such adjustments as may be necessary to best minimise variations of network charges between regulatory years and regulatory control periods.

To ensure an appropriate level of flexibility is available to address a range of circumstances in the absence of the remade 2015 determinations, in the pricing proposal process for a regulatory year in the current regulatory control period each NSW DNSP may propose and the AER may revise an annual adjustment amount so that it is different from the “default” amount determined by the AER in its adjustment amount allocation determination (the **varied annual adjustment amount**).

The proposed variation must better minimise the variation in network charges between regulatory years and regulatory control periods taking into account all relevant factors, including the revenues forecast to be recovered in the first four years of the current regulatory control period.

A feature of the proposed rule change is that it seeks to minimise network pricing volatility, while at the same time leaving the rules for the AER’s remaking of the determinations untouched. Any adjustments required to the annual revenue requirements contained in the AER’s remade 2015 determinations to manage pricing volatility are given effect through:

- The pricing proposals in the current regulatory control period (2014-2019); and
- The building blocks in the subsequent regulatory control period (2019-2020).

The proposed rule change would also operate if the AER ceases to be under an obligation to remake the 2015 determinations, but as a consequence of the actual or forecast revenues recovered or if the AER remakes its determinations on or after the commencement of the final regulatory year of the current regulatory control period by

providing for the recovery or payment of the adjustment amount in the subsequent regulatory control period.

The NSW DNSPs consider that the proposed participant derogation makes an important contribution to the achievement of the national electricity objective (NEO) by allowing the NSW DNSPs to recover any increase in their annual revenue requirements for the current regulatory control period over two regulatory periods, thereby avoiding price shocks for NSW consumers while allowing the NSW DNSPs to recover the revenue that they are entitled to. The NSW DNSPs consider that the proposed participant derogation is the most preferable rule to achieve this contribution to the NEO.

In addition, the NSW DNSPs consider that the proposed participant derogation is consistent with the revenue and pricing principles and, in particular, provides the NSW DNSPs with a reasonable opportunity to recover at least their efficient costs (as determined by the AER in the remade 2015 determinations) while minimising price shock for NSW consumers.

## 2 Proponents

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The proponents for the participant derogation are the NSW DNSPs:

- Ausgrid, a New South Wales State Owned Corporation incorporated under the Energy Services Corporations Act 1995 (NSW) (**Ausgrid**).
  - Address: 570 George Street, Sydney, NSW, 2000.
- Endeavour Energy, a New South Wales State Owned Corporation incorporated under the Energy Services Corporations Act 1995 (NSW) (**Endeavour Energy**).
  - Address: 51 Huntingwood Drive, Huntingwood NSW 2148.
- Essential Energy, a New South Wales State Owned Corporation incorporated under the Energy Services Corporations Act 1995 (NSW) (**Essential Energy**).
  - Address: Suite 3, Level 12, 227 Elizabeth Street, Sydney NSW 2000.

## 3 Statement of issue

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### 3.1 2015 determinations and merits review

The AER is responsible for the economic regulation of the NSW DNSPs under section 15(1)(f) of the National Electricity Law (NEL) and is given obligations in relation to the making of distribution determinations and the approval of pricing proposals under Chapter 6 of the NER. Each NSW DNSP must comply with the distribution determination that applies to the electricity network services it supplies under section 14B of the NEL.

The 2015 determinations were made by the AER in April 2015 to apply until 30 June 2019. Each of the 2015 determinations was a 'reviewable regulatory decision' under section 71A of the NEL.

The NSW DNSPs and other third parties applied to the Tribunal for a review of their 2015 determinations under section 71B of the NEL. On 26 February 2016, the Tribunal delivered its Decision on these reviews. The Tribunal's Decision set aside the 2015 determinations and remitted them to be remade by the AER in accordance with the Tribunal's directions under section 71P of the NEL. The AER's application of the reasons for the Tribunal's Decision in the remade 2015 determinations may result in a significant

increase or decrease in the annual revenue requirements (as applicable) in the current regulatory control period for each of the NSW DNSPs.

The AER has sought reviews in the Full Federal Court of the Tribunal's Decisions under the *Administrative Decisions (Judicial Review) Act 1977 (Cth) (ADJR Act) (ADJR Applications)*. The AER has not sought an interim order in the Full Federal Court that the Tribunal's Decisions be stayed pending the hearing of the ADJR Applications. The possible outcomes of the ADJR Applications include that the Full Federal Court: dismisses the ADJR Applications on the AER; or upholds in whole or in part the ADJR applications of the AER and the matters be referred back to the Tribunal for further consideration, subject to such directions as the court thinks fit.

The proposed rule change has been prepared to mitigate the pricing impact of any higher revenues arising from the remade 2015 determinations taking effect in the final year of the current regulatory control period by permitting the recovery of a portion of any higher revenues over the subsequent regulatory control period. For completeness, the proposed rule change is symmetrical with any decrease in the annual revenue requirements of the NSW DNSPs being treated in the same way.

### 3.2 Remaking of the 2015 determinations

There is a real chance that the AER will be required to remake the 2015 determinations either as a consequence of the Tribunal's Decisions or as a consequence of some future Tribunal decision that is made in accordance with orders of the Full Federal Court in the ADJR Applications.

If required to remake the 2015 determinations, the AER must undertake the same fundamental steps as it took when it made the 2015 determinations. The process that the AER was required to follow when making the 2015 determinations is set out in part E of Chapter 6 of the NEL. While the timing for the AER's remaking of the 2015 determinations is currently unknown, it is unlikely that the remade 2015 determinations will be in place until the fifth year of the current regulatory control period and the illustrative examples in this submission adopts this assumption.

If required to remake the 2015 determinations, the AER must do so in accordance with the Tribunal's directions. These directions have the potential to result in an increase or decrease in the annual revenue requirement (as applicable) for each regulatory year of the current regulatory control period when compared with the annual revenue requirements of the 2015 determinations. Network charges for 2015-2016 were set by the NSW DNSPs on the basis of the 2015 determinations, while network charges for 2016-2017 were set on the basis of undertakings given to the AER in accordance with section 59A of the NEL.

Prices for 2016-2017 standard control services as included in the s59A undertakings have been set to promote stability, predictability and transparency for all stakeholders and are based on the following parameters:

- Ausgrid 2015-2016 network charges to be increased by the annual rate of change in inflation as measured by the December to December change in the Consumer Price Index;
- Endeavour Energy 2015-2016 network charges to be increased by the annual rate of change in inflation as measured by the December to December change in the Consumer Price Index; and
- Essential Energy 2015-2016 network charges to be increased by the price path specified in the AER's 2015 determination for the regulatory year 2016-2017.

The NSW DNSPs will be entitled to recover any differences in the annual revenue requirements in the 2015 determinations and the annual revenue requirements of any remade 2015 determinations.

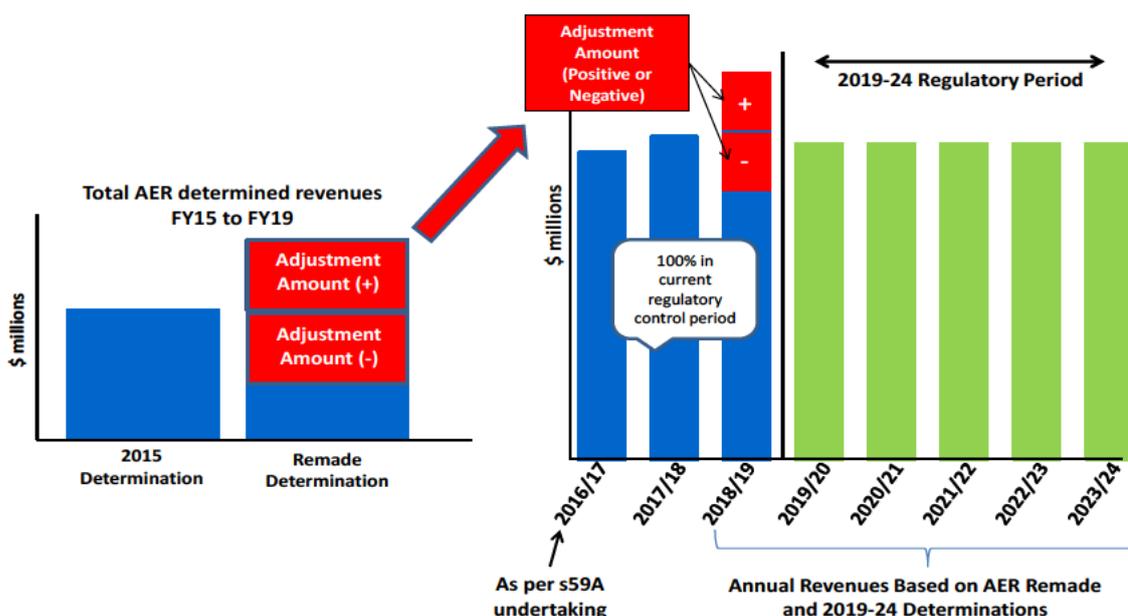
### 3.3 Potential for price shock

The NER does not clearly authorise a portion of any higher or lower revenues (as applicable) arising from the remade 2015 determinations to be recovered in the following regulatory control period.

This has the potential to lead to significant price shocks for NSW customers if the AER’s remade 2015 determinations result in an adjustment amount and if that adjustment amount is fully incorporated in network prices in the last year of the current regulatory control period. This is discussed further in section 4.4.

The following stylised example highlights how the potential for price shock may arise:

Figure 1 – Potential for price shock in the absence of a rule change



The adjustment amount as shown by the red bars in Figure 1 is based on the **sum of the annual revenue requirements** for the remade 2015 determination, less the sum of the annual revenue requirements for the 2015 determination for each NSW DNSP.

The level of actual or forecast revenues collected in Years 1 to 4 of the current regulatory control period as shown by the blue bars in the chart on the right above will also impact on the Year 5 annual revenue requirement and the revenue volatility introduced in the last year of the current regulatory control period arising from the AER’s remade 2015 determinations.

This proposed rule change has been developed to provide a mechanism to allow a proportion of the adjustment amount to be recovered through adjustments to the pricing proposals in the current regulatory control period with the balance to be recovered through an adjustment to the building blocks in the subsequent regulatory period to provide revenue and pricing stability over two regulatory control periods.

#### 3.3.1 Illustrative revenue changes in the absence of a rule change

There is a wide range of revenue outcomes that could arise from the AER’s remade 2015 determinations based on the findings of the Tribunal. While not attempting to predict any particular outcome, it is nevertheless instructive to test the revenue and pricing outcomes against an unbiased revenue scenario to assess the potential pricing impacts for NSW customers.

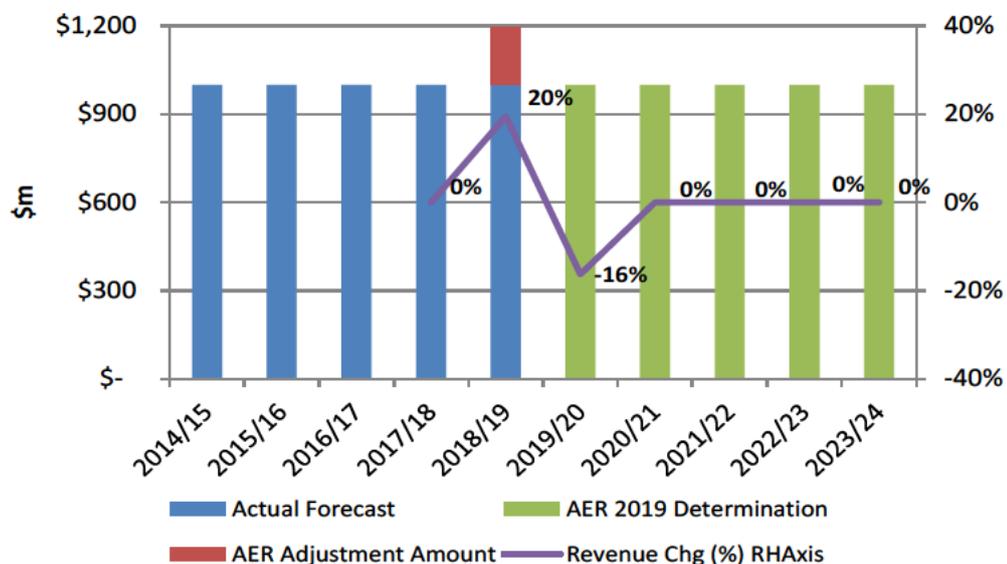
The following analysis is based on a “hypothetical” NSW DNSP, rather than a particular network business, and outlines the indicative, stylised annual revenue changes (in percentage) and the annual revenues (in \$ millions) associated with the AER’s remade 2015 determinations applying in the fifth year of the current regulatory control period.

For illustrative purposes, it is assumed in Figure 2 and Figure 3 that:

- Annual revenues in Years 1 to 4 of the current regulatory control period are pegged at \$1,000 per annum, as shown by the blue bars;
- The remade 2015 determinations incorporate approximately one quarter (25 percent) of the contested amounts arising from the Tribunal’s Decisions, or approximately three to four per cent of total revenues over the period, as shown by the red bar;
- As the 2015 determinations were set aside, there is no under- or over-recovery of revenues in Years 1 to 4; rather it is assumed that the revenues form an input to the calculation of the revenue required in Year 5 to achieve the AER’s building block revenues over the five years (in net present value terms); and
- The subsequent determination (commencing 1 July 2019) assumes annual revenues pegged at \$1,000 per annum prior to any other adjustments, as shown by the green bars.<sup>1</sup>

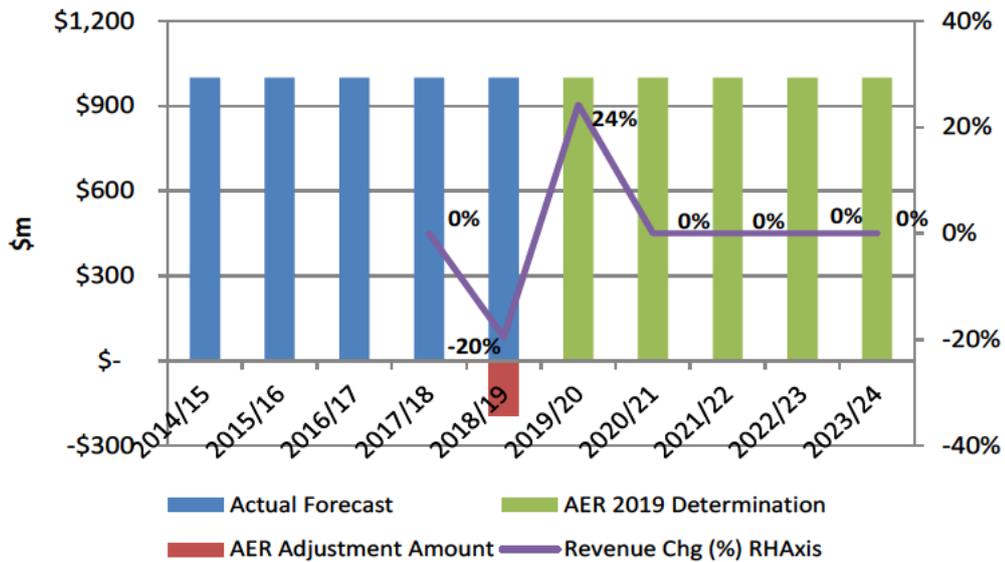
As illustrated below, in the absence of a rule change, the extent of the price shock with a positive or negative adjustment amount may be significant.

**Figure 2 – Indicative annual revenue change WITHOUT a rule change (positive adjustment amount)**



<sup>1</sup> As was discussed during pre-lodgement consultation with stakeholders, it is possible that the revenues in the subsequent regulatory control period may be higher or lower than those illustrated in Figures 2 and 3 depending on the outcomes of the AER’s ADJR application and any remade 2015 determinations. While the NSW DNSPs have not modelled all possible outcomes arising from the appeals process, it is possible that the pricing variation from 2018-2019 to 2019-2020 may be reduced somewhat from the annual changes illustrated in Figures 2 and 3 as a result of a positive adjustment amount leading to higher revenues in the subsequent regulatory control period (which would reduce the revenue variation in the first year of the subsequent regulatory control period). The same effect (lower revenue variation in the first year of the subsequent regulatory control period) is also possible for a negative adjustment amount if this leads to lower annual revenues in the subsequent regulatory control period.

**Figure 3 – Indicative annual revenue change WITHOUT a rule change (negative adjustment amount)**



As illustrated in Figure 2 and Figure 3, in the absence of a rule change and based on the assumptions noted above, the hypothetical NSW DNSP’s indicative annual revenues would increase or decrease (as applicable) by 20 percent in the last year of the current regulatory control period (2018-2019) before decreasing by 16 percent or increasing by 24 percent (as applicable) in the first year of the subsequent regulatory control period (i.e. 2019-2020), before prices stabilise from 2020-2021.

The potential annual increases or decreases (as applicable) over the remainder of the current regulatory control period followed by similarly large offsetting decreases or increases (as applicable) at the start of the subsequent regulatory control period would result in pricing volatility in the absence of a rule change that is inconsistent with the achievement of the NEO. As noted above, the magnitude of any revenue changes between the current and subsequent regulatory control periods would be affected by the annual revenue requirements in the AER’s remade determinations and the AER’s subsequent determinations for the regulatory control period starting on 1 July 2019.

For most scenarios where the Tribunal’s Decision stands and the contested revenues are included in the AER’s remade 2015 determinations in whole or in part, there is the potential for significant price shocks for NSW customers in the current regulatory control period.

Even if approximately one quarter of the contested revenues associated with the Tribunal’s decision are ultimately included in the AER’s remade 2015 determinations, network revenues in the current regulatory control period would need to increase to recover the adjustment amount in the current regulatory control period. Network revenues would then need to decrease in the first year of the subsequent regulatory control period (2019-2020) once the new determination takes effect and the impact of the adjustment amount is removed.

The “saw tooth” pricing trajectory illustrated in Figure 2 arises from the NER not clearly permitting a portion of any higher or lower revenues (as applicable) from the remade 2015 determinations to be recovered in the subsequent regulatory control period.

A similar impact on pricing volatility could occur if the AER is successful in its judicial review and the revenues recovered by the businesses in Years 1 to 4 are higher than permitted by the 2015 determinations leading to the need for lower revenues in Year 5. This possible eventuality is discussed further in section 4.1.2.

## 4 Description of the proposed participant derogation

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### 4.1 Description of the proposed participant derogation

The proposed participant derogation ensures that the rules applying to the AER's calculation of revenues in the remade 2015 determinations are untouched and that any adjustments as may be necessary to best minimise variations in network charges between regulatory years and regulatory control periods occurs through the annual pricing proposal process for the current regulatory control period.

Any adjustment amount that is carried forward to the subsequent regulatory control period would be addressed through an adjustment to the building blocks in the determination for the subsequent regulatory control period.

The proposed participant derogation would be included in Chapter 8A of the NER. A draft participant derogation to apply to the NSW DNSPs is included at Appendix 1 to this rule change request.

Conceptually, the proposed participant derogation requires the following steps, which are discussed in the sections below:

- Step 1 – Determine the adjustment amount and the allocation of this amount between regulatory control periods;
- Step 2 – Make any required adjustments in the current regulatory control period via the pricing proposal process to recover a proportion of any required adjustments in the current regulatory control period; and
- Step 3 – Make any required adjustments in the subsequent regulatory control period via the building block process to recover the remaining proportion of any required adjustments in the subsequent regulatory control period.

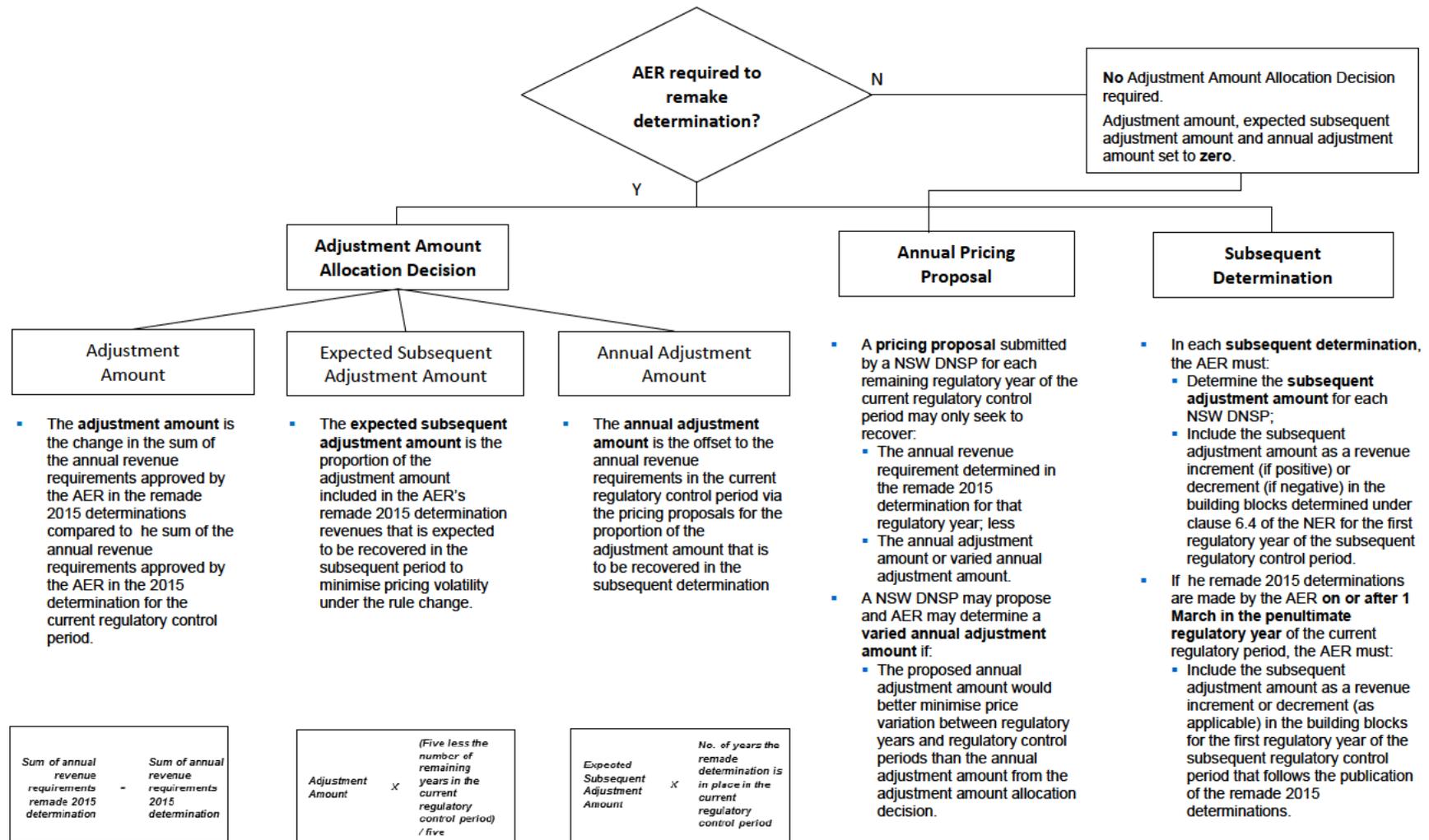
The proposed participant derogation is implemented by the AER making a separate determination (**adjustment amount allocation determination**) at the time of making the remade 2015 determination that sets out:

- The adjustment amount for each NSW DNSP (discussed in Step 1);
- The expected subsequent adjustment amount for the subsequent regulatory control period for each NSW DNSP (discussed in Step 1); and
- The annual adjustment amount for each remaining regulatory year of the current regulatory control period for each NSW DNSP (discussed in Step 2).

Note: if the AER ceases to be under an obligation to remake the 2015 determinations, as may be the case if the AER is successful in its judicial review application, then the proposed participant derogation still has application. This potential eventuality and the application of the proposed participant derogation are discussed further in section 4.1.2.

A flowchart setting out the operation of the proposed participant derogation is provided on Figure 4 overleaf.

Figure 4 – Participant Derogation Flowchart



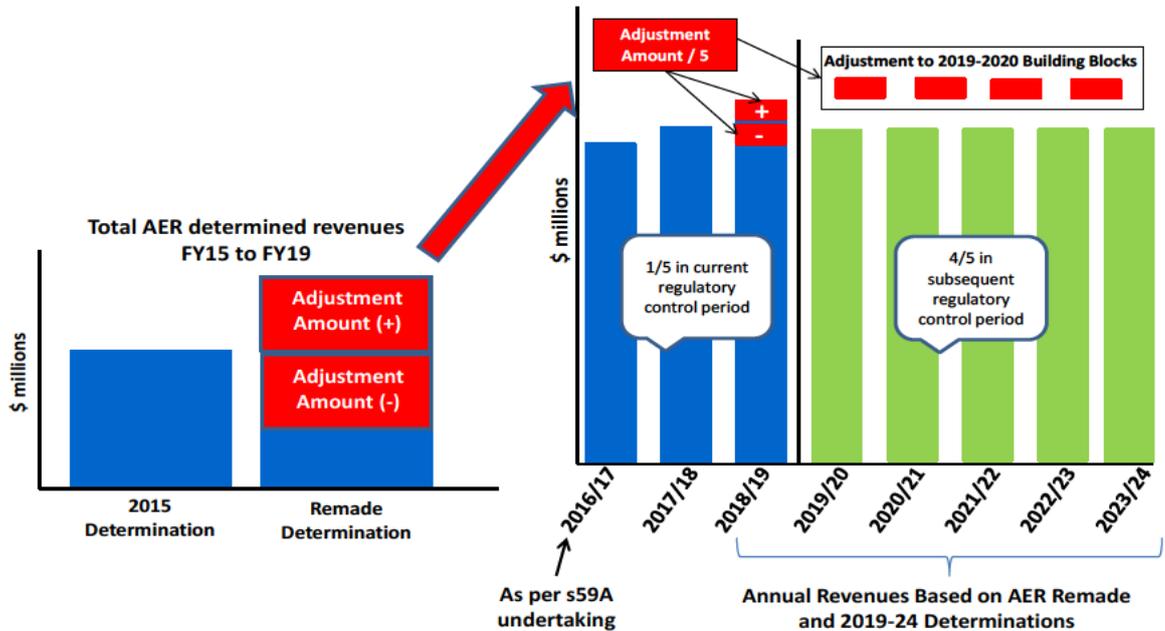
**STEP 1 – Determine the adjustment amount and the allocation between regulatory control periods**

At the time of remaking the determinations, the AER is required to determine an adjustment amount and to estimate the proportion of the adjustment amount that will be recovered in the current and subsequent regulatory control periods (by determining the expected subsequent adjustment amount).

The proposed participant derogation includes as a default position that any adjustment amount is to be allocated between the current and subsequent regulatory control periods based on an equal allocation over five regulatory years. As discussed in Step 2 below, the default position can be varied through the annual pricing proposal process in the current regulatory control period in order to minimise pricing volatility should circumstances warrant.

The calculation of the adjustment amount and its expected allocation between the current and subsequent regulatory control periods is illustrated in the stylised figure below, which builds on Figure 1 and contains both a positive and negative adjustment amount:

**Figure 5 – Calculation of the adjustment amount and allocation between regulatory periods**



As illustrated above, allocating the adjustment amount over two regulatory control periods under the proposed rule change is likely to better minimise pricing volatility than without a rule change where the adjustment amount is recovered fully in the current regulatory control period.

Allocating the adjustment amount over five years as the default position is consistent with the usual five year regulatory control period and is consistent with incentive elements contained in the regulatory framework (e.g. the five year penalty / reward period for the Efficiency Benefit Sharing Scheme and the Capital Expenditure Sharing Scheme).

While the adjustment amount is allocated between regulatory control periods on a five year default basis, the adjustment amount allocated to the subsequent regulatory control period may be recovered over all regulatory years of the subsequent regulatory control period. This is because the subsequent adjustment amount is included in the building blocks in the subsequent regulatory control period and its recovery may therefore be smoothed by the AER through the determination of the X factors.

Allocating the adjustment amount between the current and subsequent regulatory control periods based on a five year default position is seen by the NSW DNSPs as an appropriate balance between setting a longer allocation period to address the potentially significant short term price shocks that could arise from the AER's remade 2015 determinations and a shorter allocation period to avoid inefficient consumption and usage decisions (as discussed in section 5.5).

In preparing its adjustment amount allocation determination, the AER would be required to undertake the following steps:

A. Determine the **adjustment amount** for each NSW DNSP.

The **adjustment amount** represents the aggregate change in net present value terms in the sum of the annual revenue requirements approved by the AER in the remade 2015 determinations compared to the sum of the annual revenue requirements approved by the AER in the 2015 determination for the current regulatory control period.

The adjustment amount for each NSW DNSP is determined as:

- The sum of the annual revenue requirements approved by the AER in the remade 2015 determination for each regulatory year of the current regulatory control period; less
- The sum of the annual revenue requirements approved by the AER in the 2015 determination for each regulatory year of the current regulatory control period,

subject to such modifications as are necessary to ensure that:

- The sum of the total revenue requirements for the current regulatory control period approved by the AER in the 2015 determination and the adjustment amount,

is equivalent in net present value terms<sup>2</sup> to:

- The total revenue requirements for the current regulatory control period approved by the AER in the remade 2015 determination.

B. Determine the **expected subsequent adjustment amount**.

The **expected subsequent adjustment amount** represents the proportion of the adjustment amount included in the AER's remade 2015 determinations that would be recovered in the current regulatory control period in the absence of a rule change, but that is targeted to be recovered in the subsequent period to minimise pricing volatility under the rule change.

The annual revenue requirements permitted in the remade 2015 determinations implicitly include the full adjustment amount, because the AER's remaking of its 2015 determinations must be completed under the NER as currently drafted and therefore is likely to result in the sum of the annual revenue requirements in the remade 2015 determinations being higher or lower than the sum of the annual revenue requirements from the 2015 determinations (i.e. an adjustment amount is likely to exist).

If the adjustment amount is positive, and in order to reduce network charges over the remainder of the current regulatory control period, the annual revenue requirements for the remaining regulatory years of the current regulatory control period need to be

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<sup>2</sup> The treatment of inflation is a relevant implementation consideration that is inherent within the meaning of 'net present value' that would be embodied within the PTRM modelling supporting any remade decision of the AER.

reduced so as to spread a portion of the adjustment amount into the next regulatory control period. The expected subsequent adjustment amount represents the proportion of the adjustment amount that is to be recovered through the building blocks in the subsequent determination for the subsequent regulatory control period.

The expected subsequent adjustment amount is based on the default position determined by dividing the adjustment amount by 5 and allocating 1/5 to each year of the 5 year allocation period starting from the year the remade 2015 determinations are in place.

For example, if the remade 2015 determinations are in place for the last year of the current regulatory control period, the expected subsequent adjustment amount would be based on 4/5, or 80%, of the adjustment amount being recovered in the subsequent regulatory control period and 1/5, or 20%, of the adjustment amount being recovered in the current regulatory control period.

The expected subsequent adjustment amount is equivalent in net present value terms to:

- the adjustment amount;
- multiplied by the factor determined as follows:
  - Five less the number of remaining regulatory years in the current regulatory control period; divided by five, as expressed by the following formula.

$$\text{Expected subsequent adjustment amount} = \text{Adjustment Amount} \times \frac{(\text{Five less the number of remaining years in the current regulatory control period})}{\text{five}}$$

For example:

- If the AER's remade 2015 determinations are in place for the last year of the current regulatory control period, and assuming the adjustment amount equals \$100, the expected subsequent adjustment amount would be calculated as follows:

$$\begin{aligned} \text{Expected subsequent adjustment amount} &= \$100 \times \frac{(5-1)}{5} \\ &= \$100 \times 80\% = \$80 \end{aligned}$$

- If, however, the AER remade 2015 determinations are in place for the second last year of the current regulatory control period, and assuming the adjustment amount equals \$100, the expected subsequent adjustment amount would be calculated as follows:

$$\begin{aligned} \text{Expected subsequent adjustment amount} &= \$100 \times \frac{(5-2)}{5} \\ &= \$100 \times 60\% = \$60 \end{aligned}$$

Once the expected subsequent adjustment amount is determined, it is instructive to calculate the expected current adjustment amount for recovery in the current 2014-2019 regulatory control period, which is the difference between the adjustment amount and the expected subsequent adjustment amount as calculated above.

$$\text{Expected current adjustment amount} = \text{Adjustment Amount} \text{ Minus } \text{Expected subsequent adjustment amount}$$

For example:

- If the remade 2015 determinations are in place for the last year of the current regulatory period, and assuming the adjustment amount equals \$100 and the expected subsequent adjustment amount equals \$80, the expected current adjustment amount would be calculated as follows:

$$\begin{aligned} \text{Expected current adjustment amount} &= \$100 \text{ Minus } \$80 \\ &= \$100 - \$80 = \$20 \end{aligned}$$

- If, however, the remade 2015 determinations are in place for the last two years of the current regulatory period, and assuming the adjustment amount equals \$100 and the expected subsequent adjustment amount equals \$60, the expected current adjustment amount would be calculated as follows:

$$\begin{aligned} \text{Expected current adjustment amount} &= \$100 \text{ Minus } \$60 \\ &= \$100 - \$60 = \$40 \end{aligned}$$

The allocation of the expected subsequent adjustment amount from the current regulatory control period to the subsequent regulatory control period takes place via the pricing proposal process described in Step 2 below.

The recovery of the expected subsequent adjustment amount in the subsequent regulatory control period takes place via the building block process in the subsequent determination described in Step 3.

## STEP 2 – Recover revenues through the pricing proposal process

Once the expected subsequent adjustment amount has been calculated, it flows through to higher or lower network prices to manage pricing volatility through the annual pricing proposal process in each remaining year of the current regulatory control period.

- A **pricing proposal** submitted by a NSW DNSP for each remaining regulatory year of the current regulatory control period may only seek to recover:
  - The annual revenue requirement determined in the remade 2015 determination for that regulatory year; less
  - The annual adjustment amount or varied annual adjustment amount.
- In the adjustment amount allocation determination, the AER is required to determine the **annual adjustment amount** for each regulatory year remaining in the current regulatory control period.

The **annual adjustment amount** represents the offset to the annual revenue requirements in the current regulatory control period via the pricing proposals for the proportion of the adjustment amount that is to be recovered in the subsequent determination for the subsequent regulatory control period.

- The annual adjustment amount is equivalent in net present value terms<sup>3</sup> to:
  - The expected subsequent adjustment amount; divided by
  - The number of remaining regulatory years in the current regulatory control period.

<sup>3</sup> To be indexed by the appropriate discount rate to preserve net present value.

This can be expressed by applying the following formula:

$$\text{Annual Adjustment Amount} = \frac{\text{Expected Subsequent Adjustment Amount}}{\text{Divided by No. of years the remade determination is in place in the current regulatory control period}}$$

For example:

- If the AER's remade 2015 determinations are in place for the last year of the current regulatory control period, and assuming the expected subsequent adjustment amount is \$80 as per the earlier example, the annual adjustment amount that is to be offset from the Year 5 annual revenue requirement and recovered in the subsequent regulatory control period would be calculated as follows:

$$\begin{aligned} \text{Annual Adjustment Amount} &= \$80 \text{ Divided by } 1 \text{ Year} \\ &= \$80 / 1 = \$80 \end{aligned}$$

- If the AER's remade 2015 determinations are in place for the last two years of the current regulatory period, and assuming the expected subsequent adjustment amount is \$60 as calculated above, the annual adjustment amount for both Year 4 and Year 5 would be calculated as follows:

$$\begin{aligned} \text{Annual Adjustment Amount} &= \$60 \text{ Divided by } 2 \text{ Years} \\ &= \$60 / 2 = \$30 \end{aligned}$$

- For clarity, the annual adjustment amount calculation as illustrated above represents the proportion of the adjustment amount included in annual revenue requirements in the AER's remade 2015 determination that is targeted to be recovered in the subsequent regulatory control period. As such, the annual adjustment amount needs to be removed from the annual revenue requirements in the AER's remade 2015 determinations through the pricing proposal in Year 4 and or Year 5 (as relevant) to avoid double counting.

For the avoidance of doubt, the proposed participant derogation **provides for adjustments to the pricing proposals to be made only in the current regulatory control period** (i.e. adjustments to the pricing proposals cannot be made in the subsequent regulatory control period as revenue smoothing will be undertaken by the AER in its final decision for that period).

### **STEP 3 – Include the subsequent adjustment amount in the subsequent determination**

The final step in the proposed participant derogation process is to require the AER to include any revenue increment or decrement (as applicable) arising from the pricing proposal process discussed above in the subsequent determination through an adjustment to the building block revenues the subsequent regulatory control period as described below.

In each subsequent determination, the AER must:

- Determine the **subsequent adjustment amount** for each NSW DNSP; and
- Include the subsequent adjustment amount as a revenue increment (if positive) or decrement (if negative) in the building blocks determined under clause 6.4 of the NER for the first regulatory year of the subsequent regulatory control period.

The subsequent adjustment amount is the sum of all annual adjustment amounts or varied annual adjustment amounts that applied in the current regulatory control period. It is the adjustment amount for the subsequent regulatory control period that was actually applied during in the current regulatory control period, which may or may not be equal to the expected subsequent adjustment amount as determined by the AER in the allocation adjustment amount decision (i.e. the two amounts would be equal unless a varied annual adjustment amount was proposed by a NSW DNSP and accepted by the AER, or revised by the AER).

Including the subsequent adjustment amount as a revenue increment or decrement in the building blocks in the subsequent determination<sup>4</sup> provides maximum flexibility for the AER to calculate X factors and to address potential price shocks within the subsequent regulatory control period.

The determination by the AER of the subsequent adjustment amount is taken to be a constituent decision for the purposes of clause 6.12.1 of Chapter 6 of the NER.

Finally, the participant derogation is proposed to **expire** at the end of the subsequent regulatory control period.

#### 4.1.1 Circumstances in which the annual adjustment amount can be varied

In the pricing proposal process for a regulatory year in the current regulatory control period, a NSW DNSP may propose and the AER may revise (with or without a proposed variation from the NSW DNSP) an annual adjustment amount so that it is different from the annual adjustment amount determined by the AER in its adjustment amount allocation determination (a **varied annual adjustment amount**) if the proposed annual adjustment amount would better minimise price variation between regulatory years and regulatory control periods than the annual adjustment amount referred to above taking into account:

- The change in annual revenue requirements between the fourth and fifth regulatory years of the current regulatory control period ending on 30 June 2018 and 30 June 2019 respectively as a result of the remade 2015 determination;
- The known and forecast revenues recovered or to be recovered by the relevant NSW DNSP at the time of the remade 2015 determination; and
- Any other relevant factor.

The AER must accept the varied annual adjustment amount proposed by the NSW DNSP if it is **satisfied** that the proposed varied annual adjustment amount would better minimise variations in network charges for that NSW DNSP's. For clarity, if the AER is not satisfied that the varied annual adjustment amount would better minimise pricing volatility, it is not required to accept the NSW DNSP's proposed variation.

The AER may revise an annual adjustment amount (with or without a proposed variation from the NSW DNSP) on the same basis as it may accept a proposed varied annual adjustment amount.

In proposing or revising a varied annual adjustment amount, the NSW DNSP or the AER (as applicable) needs to take into account:

<sup>4</sup> To be indexed by the appropriate discount rate to preserve net present value.

- The pricing volatility that would otherwise arise based on the change in annual revenue requirements between the fourth and fifth years of the current regulatory control period (2017-2018 and 2018-2019);
- The known and forecast revenues recovered or to be recovered in the current regulatory control period; and
- Any other relevant factor.

In addition to seeking to manage pricing volatility by spreading the adjustment amount over two regulatory control periods, the NSW DNSPs are also seeking to ensure that the actual or forecast revenues collected by the businesses in the lead up to the remade 2015 determinations do not lead to unacceptable pricing volatility, even in the absence of a material adjustment amount. This is due to the following:

- Clause 6.5.9 of the NER requires that the AER sets X factors in its determinations to, amongst other things, “equalise (in terms of net present value) the revenue to be earned by the [DNSP] from the provision of standard control services over the regulatory control period with the provider’s total revenue requirement for the regulatory control period”.
- The level of actual or forecast revenues collected in Years 1 to 4 of the current regulatory control period is expected to impact on the Year 5 annual revenue requirement in the remade 2015 determinations.
- The actual or forecast revenues collected by each NSW DNSP in the lead up to the remade 2015 determinations would be expected to be included by the AER in its Post Tax Revenue Model (PTRM) when it undertakes its revenue smoothing.
- While the 2015 determinations being set aside by the Tribunal renders the concept of any “under- or over-recovery” moot in the lead up to the remade 2015 determinations, the actual or forecast revenues collected in the first four years of the current regulatory control period nonetheless may impact on the level of the annual revenue requirement in Year 5;
- Even in the absence of a material adjustment amount, it is not inconceivable that the variation in the annual revenue requirements in the remade 2015 determinations between the fourth and fifth years could lead to significant pricing volatility.

Therefore, there is merit in providing flexibility to the AER to accept a varied annual adjustment amount proposed by a NSW DNSP in its pricing proposals in the current regulatory control period that takes into account actual or forecast revenues collected, the annual revenue requirements in Years 4 and 5 of the current regulatory control period or any other relevant consideration that may affect pricing volatility.

The approach of adjusting the annual revenue requirement by the annual adjustment amount to calculate an adjusted annual revenue requirement for each remaining regulatory year in the current regulatory control period has the effect of leaving the remade 2015 determinations untouched, while:

- Providing a mechanism where each NSW DNSP in its annual pricing proposal sets network tariffs based on revenues that are lower (in the case of a positive adjustment amount) than that annual revenue requirement contained in the remade 2015 determination, which would *a priori* reduce network prices in the current regulatory control period;
- Reducing the annual revenue requirement by the annual adjustment amount is deemed to be a permitted variation from the pricing principles in clauses 6.18.5(e) to 6.18.5(j) of the NER; and

- Confirming that any variation in proposed tariffs caused by the remade 2015 determination and the reduction to the annual revenue requirement by the adjustment amount will be deemed to be explained by this derogation for the purposes of clause 6.18.8(a)(2).

As discussed in section 4.1.2 below, if the AER ceases to be under an obligation to remake the 2015 determination for a NSW DNSP, the annual adjustment amount is deemed to be zero, a NSW DNSP is also able to propose a varied annual adjustment amount if it would better minimise pricing volatility.

A more fulsome description of these considerations is provided in the proposed participant derogation drafting provided at Appendix 1.

#### 4.1.2 If AER ceases to be under an obligation to remake the 2015 determinations

The proposed participant derogation also applies if the AER ceases to be under an obligation to remake the 2015 determinations. This situation could arise if the Full Federal Court finds in favour of the AER in its ADJR application, thereby negating the need for the AER to remake the 2015 determinations or if the Tribunal is required to remake its decisions and in doing so finds that there are no grounds for review and that the AER's 2015 determinations are to be reinstated.

In either of these events, the proposed participant derogation provides for the smoothing of the annual revenue requirements across regulatory control periods to minimise potential pricing volatility even if the AER is not required to remake the 2015 determinations.

Potential pricing volatility may occur even if the 2015 determinations are not required to be remade because, under a revenue cap form of regulation, controls are placed on the total revenue a DNSP is allowed to earn over a regulatory control period (currently a five year regulatory control period in the case of the NSW DNSPs).

Therefore if, as an example, a NSW DNSP has collected higher or lower revenues (as applicable) vis-à-vis the original 2015 determination over the first four years of the current regulatory control period, then the allowed revenue in the fifth year of the current regulatory control period will necessarily need to be reduced or increased (as applicable) to meet the total revenue requirement allowed by the AER in its 2015 determination (in net present value terms<sup>5</sup>) over the five year regulatory control period.

This scenario is set out in more detail in Box 1 (section 4.3) and highlights that flexibility would appear desirable to manage pricing volatility even if the AER is no longer under an obligation to remake the 2015 determinations.

The operation of the proposed participant derogation if the AER is not required to remake the 2015 determinations would occur for each NSW DNSP as follows:

1. The AER is **not** required to make an adjustment amount allocation determination for that NSW DNSP; however
2. As the adjustment amount, expected subsequent adjustment amount and annual adjustment amount are each required for the operation of the proposed participant derogation in order to minimise pricing volatility, **each of these amounts is deemed to be zero** for that NSW DNSP.

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<sup>5</sup> To be indexed by the appropriate discount rate to preserve net present value.

The **deeming of the annual adjustment amount, expected subsequent adjustment amount and annual adjustment amount to be zero** has been included in the proposed participant derogation as a necessary procedural step to allow each NSW DNSP to propose and the AER to revise an annual adjustment amount that is not equal to zero if this would better minimise pricing volatility during the pricing proposal process.

#### 4.1.3 Recovery of revenue if the remade 2015 determinations are made by the AER on or after the commencement of the final year of the current period

The proposed participant derogation also applies if the remade 2015 determinations are made by the AER on or after 1 March of the penultimate regulatory year of the current regulatory period. In this circumstance the AER must:

- At the time of making the remade 2015 determination, determine an adjustment amount in the same manner as outlined in section 4.1 above; and
- **Make or remake** the subsequent determinations (as applicable) so that the adjustment amount is included as a revenue increment (if positive) or decrement (if negative) in the building blocks determined under clause 6.4 of the NER for the first regulatory year of the subsequent regulatory control period that follows the publication of the remade 2015 determinations.
- The determination by the AER of the adjustment amount is taken to be a constituent decision for the purposes of clause 6.12.1 of Chapter 6 of the NER.

#### 4.2 How the proposed participant derogation resolves the issue

The proposed participant derogation resolves the potential for significant price volatility by enabling a portion of the adjustment to the annual revenue requirements for the current regulatory control period to be spread into the subsequent regulatory control period, rather than requiring the adjustment amount to be recovered exclusively in the current regulatory control period.

At the same time, the proposed participant derogation leaves the rules for the AER's remaking of the 2015 determinations untouched.

A feature of the proposed participant derogation is that its starting point is the annual revenue requirements contained in the AER's remade 2015 determinations – therefore the rules setting out how the AER is to remake the Determinations remain unchanged.

The proposed adjustments to minimise pricing volatility are as follows:

- Any adjustments required in the current regulatory control period are given effect through the **pricing proposal process**; and
- Any corresponding adjustments in the subsequent regulatory control period are given effect through increments or decrements (as applicable) to the **building block revenues** (section 6.4 of the NER) in the subsequent determination.

Since, *a priori*, lower revenues flow through to lower network prices, recovering a portion of any revenue increase over two regulatory control periods will assist in minimising any network price increase that would otherwise occur in 2017-2018 and 2018-2019 in the absence of the rule change.

The default position of a mechanistic approach to resolving any revenue adjustment provides certainty to customers, retailers and network service providers regarding future pricing trends, while also providing the AER with a transparent and administratively simple approach to implementing the rule change.

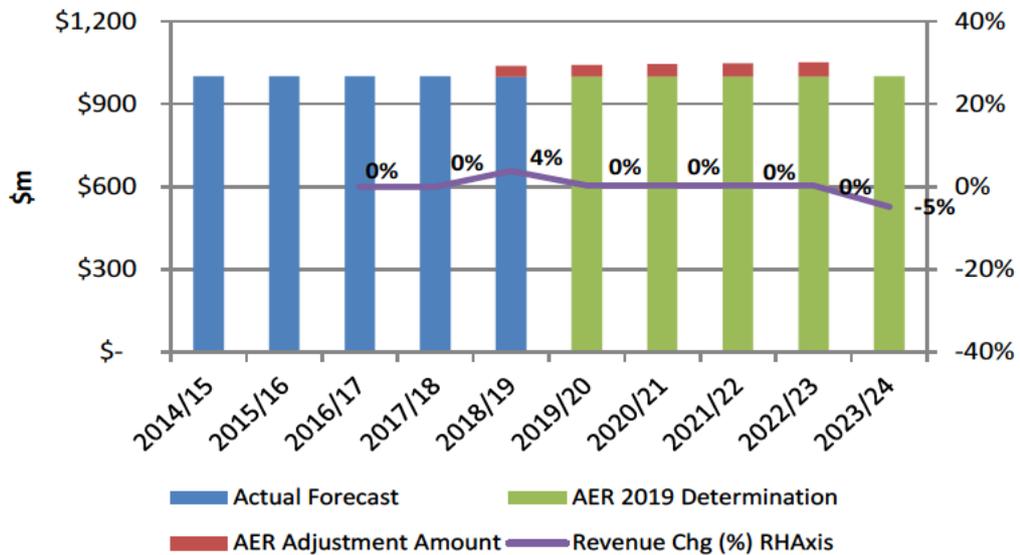
As discussed in section 4.3 below, flexibility is incorporated into the proposed rule change through the ability to propose a varied annual adjustment amount to ensure that the objective of avoiding pricing volatility can be achieved under a wide range of circumstances.

The following chart illustrates the revenue and pricing effects of recovering a proportion of the adjustment amount in the subsequent regulatory control period by allocating the adjustment amount over two regulatory control periods assuming equal recovery over five years (the default position).

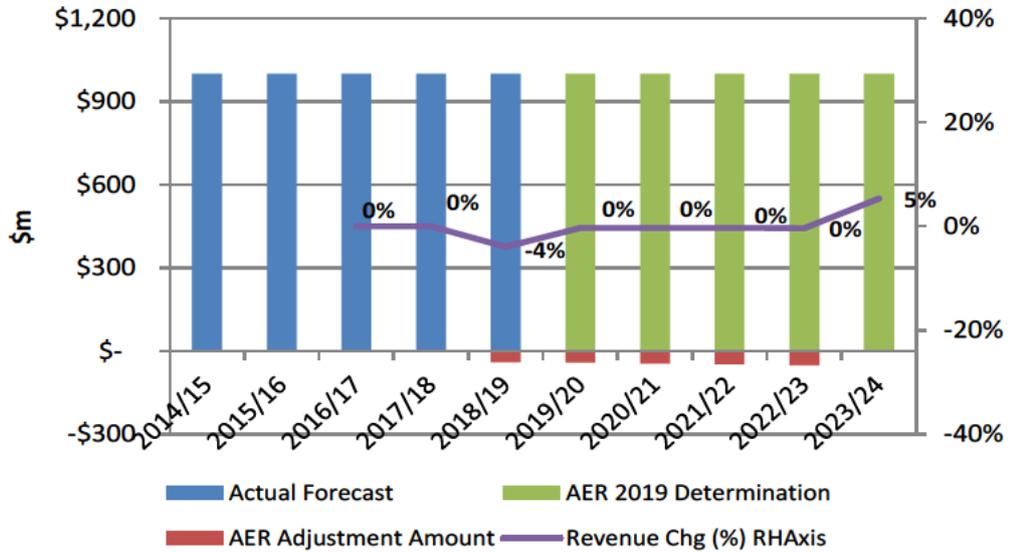
All other assumptions are consistent with those underpinning the “without a rule change” case illustrated in Figures 2 and 3.

Note: It is not a requirement that the subsequent adjustment amount will only be recovered during the first 3 or 4 years of the subsequent regulatory control period, as it is included in the building blocks for the first year of the subsequent regulatory control period and may be recovered over the whole of the subsequent regulatory control period through the setting of X factors by the AER as a result.

**Figure 6 – Illustrative annual revenue change WITH a rule change (positive adjustment amount)**



**Figure 7 – Illustrative annual revenue change WITH a rule change (negative adjustment amount)**



As illustrated above, recovering any positive or negative adjustment amount (assuming one quarter of the contested amounts from the Tribunal’s decision) over two regulatory periods avoids the situation where revenues and consequently network charges would otherwise need to:

- Increase or decrease significantly (as applicable) in the last year of the current regulatory control period; then
- Decrease or increase significantly (as applicable) in the first year of the subsequent regulatory control period once a new determination takes effect.

The annual revenue changes (in percent) for the scenarios “with” and “without” the proposed rule change and assuming the default allocation position are summarised in Table 1 below:

**Table 1 – Illustrative nominal revenue changes (%) WITH and WITHOUT a rule change**

	Adjustment Amount	2018/19 Revenue Change (%)	2019/20 Revenue Change (%)
<b>WITHOUT a rule change</b>	Positive	+20%	-16%
	Negative	-20%	+24%
<b>WITH a rule change</b>	Positive	+4%	0%
	Negative	-4%	0%

As summarised in Table 1, the “saw tooth” pricing trajectory in the absence of a rule change that was evident in Figures 2 and 3 are not evident in the presence of a rule change as illustrated in Figures 6 and 7.

The above figures and analysis have been based on the change in total annual revenue requirements assuming the default position of allocating 1/5 of any adjustment amount in the current regulatory period and 4/5 in the subsequent regulatory control period. The analysis does not represent the impact customers might expect to see on their bills,

given that the absolute level of customer bills will be driven by the revenue outcomes contained both in the remade 2015 determinations and the subsequent determinations.

However, in order to provide customers with an indication of an illustrative impact that the proposed rule change might have on their future bills, each NSW DNSP has assessed the dollar impact of the rule change compared to the status quo (i.e. no rule change).

The following table highlights the illustrative change in bills (in dollars) that an average residential customer consuming 5 MWh p.a. in each of the network areas could expect in 2018-2019 (i.e. FY19) and the offsetting changes in the following four years as a direct result of the proposed rule change assuming the default position:

**Table 2 – Indicative bill reduction for a residential customer consuming 5 MWh pa due to the rule change**

	Illustrative <u>revenue</u> adjustment amount  (\$millions)  (a)	Illustrative <u>bill Impact</u> due to rule change	
		2018-2019  (\$)  (b)	Avg 4 years from FY20  (\$)  (c)
NSW DNSP			
Ausgrid	+/- \$440m	-/+ \$100	+/- \$25
Endeavour Energy	+/- \$130m	-/+ \$105	+/- \$25
Essential Energy	+/- \$57m	-/+ \$30	+/- \$10

Table 2 provides:

- The illustrative revenue adjustment amount (in \$millions) associated with a revenue increase or decrease (as applicable) assuming an illustrative revenue adjustment as shown in column (a);
- The illustrative change in an indicative residential customer’s annual bill in 2018-2019 associated with a positive or negative annual adjustment (as applicable), as shown in column (b). For clarity, these amounts do not reflect the expected annual network bill for a residential customer; rather they illustrate the indicative change in a 2018-2019 annual bill solely as a result of recovering the adjustment amount over two regulatory control periods as opposed to one regulatory control period;
- The average change in an indicative residential customer’s average bill over the first four years of the subsequent regulatory control period as a result of the proposed participant derogation, as shown in column (c). The illustrative bill changes in column (c) are offsetting movements to those shown in column (b). That is, if there is a bill change in 2018-2019 as a result of a positive or negative adjustment amount (as applicable) as shown in column (b), there would need to be an offsetting change to bills in the four years from 2019-2020 (i.e. FY20) as a result of the rule change to ensure there is no double counting.

Table 2 highlights that with a positive adjustment amount, the rule change results in a bill reduction in 2018-2019 relative to a “no rule change” scenario, followed by offsetting average bill increases over the next four years. Similarly, with a negative adjustment amount, the rule change results in a bill increase in 2019-2020 relative to a “no rule change” scenario followed by offsetting average bill decreases over the next four years.

As illustrated above, the proposed rule change has the potential to significantly reduce pricing volatility compared to a scenario without the proposed rule change.

For the avoidance of doubt, the bill impacts in Table 2:

- Are indicative only and are for the purposes of providing the reader with illustrative outcomes associated with the proposed rule change;
- Only relate to the impact of the proposed rule change; and
- Do not represent absolute bill levels.

### 4.3 The need to provide flexibility for unforeseen circumstances

Under some circumstances, the strict application of the rule change and the recovery of the adjustment amount over five years across two regulatory periods from the time of the AER’s remade 2015 determinations (the default position) with no flexibility would not lead to the intended outcome of minimising pricing volatility for NSW consumers.

Consider the example in Box 1:

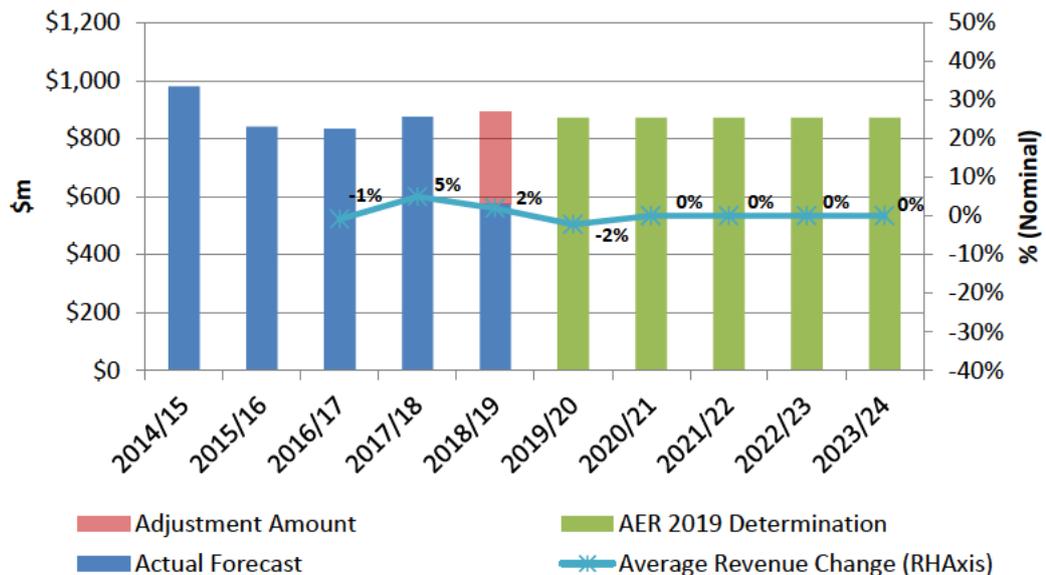
**Box 1:** A NSW DNSP recovers higher actual (or forecast) annual revenues in the first four years of the regulatory control period than those envisioned in the 2015 determinations and there is a relatively small (or zero) adjustment amount arising.

In this example the rule change would require the NSW DNSP to set network prices to recover the annual revenue requirement from the remade 2015 determinations in Year 5. The combination of relatively high revenues in Years 1 to 4 and a small (or zero) adjustment amount, would lead to network prices needing to be reduced in Year 5 to meet the overall revenue outcomes in the AER’s remade 2015 determination.

To highlight the potential impact, the example below assumes that one half (50 percent) of the contested amounts from the Tribunal’s decision are reflected in the AER’s remade 2015 determinations.

This example is illustrated in Figure 8 below:

**Figure 8 – Revenue change Without a Rule Change – 50 percent scenario**



The figure above illustrates the adjustment amount (red column) that represents both:

- The maximum adjustment amount that could be applied in the current regulatory control period without the need for some recovery in the subsequent regulatory control period; and
- In the case of a small (or zero) adjustment amount, a different annual adjustment amount that could be proposed by the NSW DNSP to minimise pricing volatility otherwise in Year 5 (the blue columns) in the current regulatory control period. Any such adjustment would then become an offsetting revenue adjustment (in net present value terms) in the subsequent determination.

This example demonstrates that it is possible to achieve pricing stability under a range of circumstances by adjusting revenues in the final year of the current regulatory control period to minimise the pricing volatility. There may be some circumstances where allocating 1/5 of the adjustment amount to the current regulatory control period (the default position) may not minimise pricing volatility and, in fact may lead to greater pricing volatility than not deferring any proportion of the adjustment amount to the subsequent regulatory control period.

The analysis also suggests that providing each NSW DNSP with the ability to propose a variation to, and for the AER to revise, the annual adjustment amount (e.g. recover a higher or lower proportion of the adjustment amount in the current regulatory control period than the default position would imply) would better minimise variations in network charges compared to both the default position or the status quo (i.e. no rule change).

The flexibility to enable an adjustment to the pricing proposals to facilitate the smoothing of prices in these circumstances would appear desirable.

Next consider the example in Box 2:

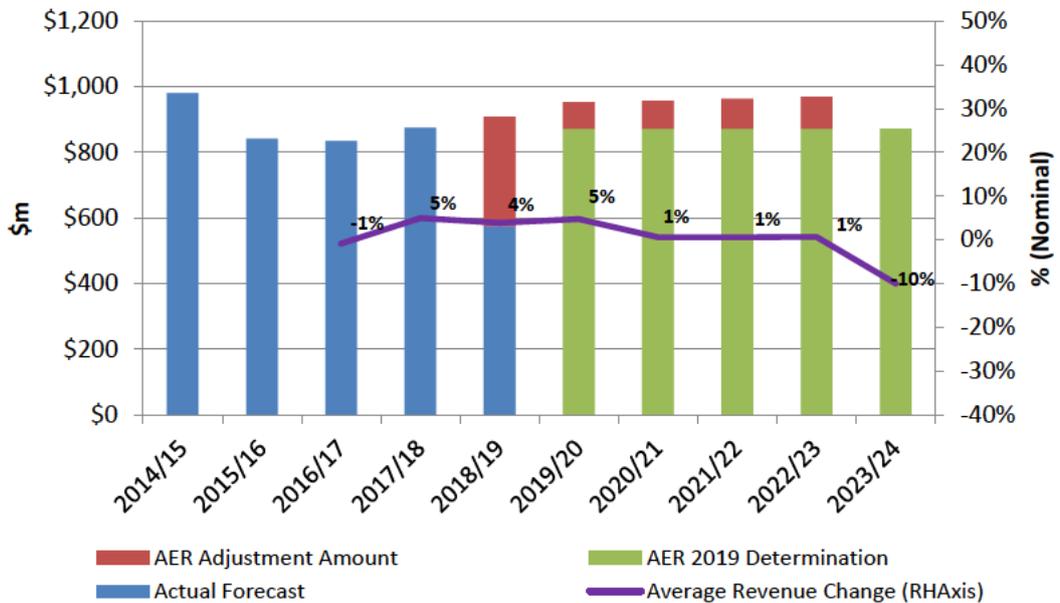
**Box 2:** *A NSW DNSP recovers higher actual (or forecast) annual revenues in the first four years of the regulatory control period than those envisioned in the 2015 determinations and there is a relatively large adjustment amount arising from the remade 2015 determination.*

In this example, which builds on the scenario in Box 1, the adjustment amount is sufficiently large such that some allocation to the subsequent regulatory control period is desirable to minimise pricing volatility.

The application of an equal recovery of the adjustment amount over the remaining regulatory years of the current regulatory control period and the subsequent regulatory control period for each year of the allocation period (the default position) in this example would not be optimal in reducing volatility.

As highlighted in Figure 9 below, revenue volatility could be minimised if flexibility was provided to the NSW DNSP to propose a variation to, and for the AER to revise, the default position that could better minimise the annual revenue requirement variations, such as by allocating a greater proportion of the adjustment amount to the current regulatory control period.

**Figure 9 – Revenue change WITH rule change and variable recovery between periods**



In this example, an allocation of the adjustment amount between regulatory control periods that brings forward a greater proportion of the adjustment amount to the current regulatory control period, with a lesser allocation to the subsequent regulatory control period would be preferable in minimising regulatory volatility.

The participant derogation provides flexibility for the NSW DNSPs to propose, and for the AER to accept, a variation to the annual adjustment amount in the annual pricing proposal to address any change in annual revenue requirements between Years 4 and 5 of the current regulatory control period if greater pricing stability can be achieved.

In the absence of visibility of the timing or quantum of the AER’s remade 2015 determinations, a pragmatic approach is one that provides sufficient flexibility for the NSW DNSPs to propose, and for the AER to accept, varied annual adjustment amounts to minimise price volatility under a wide range of circumstances.

#### 4.4 NER does not address this issue

The NER does not clearly permit a portion of any higher or lower revenues (as applicable) arising from the remade 2015 determinations to be recovered in the following regulatory control period as a result of the setting of X-factors.

To enable the recovery of higher or lower revenues (as applicable) in the following regulatory control period, the AER would have to set X-factors that result in smoothed revenues for the regulatory control period, the total of which is less than the total revenue requirement for the current regulatory control period.

Clause 6.5.9 of the NER does not permit the AER to set such an X-factor. Clause 6.5.9 of the NER requires the X-factors to be set so as to smooth the total revenue requirement for a regulatory control period within that regulatory control period.

Clause 6.4.3 of the NER provides for unders and overs to be included in the building blocks, but these unders and overs must be as a result of the control mechanism. The control mechanism for standard control services is a year-on-year revenue cap, which caps allowed revenue.

The current rules are unlikely to assist the AER in managing the pricing volatility in the last year of the current regulatory period in the absence of the proposed rule change because prices generally must be set to recover allowed revenues.

The NER, therefore, does not clearly address the implications of an extended merits review process on the recovery of allowed revenue within and between regulatory control periods.

#### 4.5 Participant derogation vs wider rule change

The NSW DNSPs consider that the present circumstances suggest that a rule change applying only to the proponents is more appropriate than a wider rule change that would apply to all distribution network service providers.

The combination of a number of events have prolonged the likely determination of annual revenues for the current regulatory control period and have led to the potential for pricing volatility for NSW customers. These events include:

- The 2014-2015 “transitional” regulatory control period;
- The findings of the Tribunal in its merits review decision;
- The potential size of difference between in annual revenue requirements between the 2015 determinations and the remade 2015 determinations;
- The likely time for the AER to remake the determinations; and
- the AER’s application for judicial review of the Tribunal’s decision.

These matters in aggregate only apply to the NSW DNSPs (and ActewAGL) and not all DNSPs operating in the national electricity market (**NEM**).

The short period of time available for the recovery of any additional revenue allowed by the AER’s remade decision is unprecedented and caused, in part, by the “transitional” regulatory control period commencing for the NSW DNSPs in the year prior to the 2015 determinations as a result of the transitional provisions inserted for the *National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012*.

It is not envisioned that a similar one year delay arising from similar transitional arrangements intended to apply a wider rule change to the NSW DNSPs (and ActewAGL) is likely to occur again.

An unforeseen consequence of these transitional provisions was a delay in resolving the merits review brought by the NSW DNSPs (and ActewAGL) leading to the potential price shock referred to above.

The findings of the Tribunal whereby the determinations were remitted to the AER to remake, the extended time period signalled by the AER to remake its determinations and the AER’s application for judicial review of the Tribunal’s decision could all impact on the ability to minimise price shocks for customers within the current regulatory control period.

It would seem appropriate that consideration of whether a participant derogation or wider rule change is to apply should be tested against a set of criteria. The NSW DNSPs consider that the following criterion should be applied, each of which has contributed to the potential pricing volatility for NSW customers:

- **Criterion 1** – Was a transitional determination in place in the year prior (but impacting on) the current regulatory control period, thereby extending the normal determination process by one year and reducing the available recovery period to manage price shocks to customers?

- **Criterion 2** – Did the business seek leave to appeal by the Tribunal of the AER’s determinations under section 71C of the NEL (**Merits Review**) and was that leave granted?
- **Criterion 3** – Did the Tribunal establish grounds for review in its merits review decisions and set aside the AER’s determinations for remaking?
- **Criterion 4** – Are there potential price shocks or impacts on the operations of the business arising from the remade 2015 determinations that are significant?
- **Criterion 5** – Has the AER signalled a lengthy process for the remaking of the determinations with remade 2015 determinations not expected until at least the penultimate year or final year of the current regulatory control period?
- **Criterion 6** – Is the AER seeking judicial review of the Tribunal’s merits review decision, which may require matters to be remitted to the Tribunal to re-determine?

The NSW DNSPs (and ActewAGL) are the only electricity distribution network service providers where the answer to each of the above questions is “yes”. Furthermore, it is not envisioned that this issue is likely to arise again with all (or even most) of the criteria above not being relevant to the majority of DNSPs.<sup>6</sup>

A participant derogation modifies or varies the application of a provision of the rules to a person or class of person.

Accordingly, a participant derogation applying only to the proponents, rather than a wider rule change applying to all electricity distribution network service providers, is appropriate to deal with this issue given the limited number of network service providers that are likely to experience similar circumstances.

The additional time and complexity associated with consulting across industry to pursue a broader rule change that caters for all conceivable eventualities is likely to be unwarranted in the current circumstances, when the specific circumstances are well understood and upon us.

For clarity, the NSW DNSPs are not seeking to change the rules to apply to any DNSP that seeks to appeal an AER determination; rather, the businesses are seeking to address the present circumstance in NSW where an AER determination is unlikely to be in place until the fifth year of the current regulatory period and the pricing volatility this is likely to cause.

## 5 Contribution to the NEO

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The NEL sets out the framework that the AEMC must apply when considering a rule change proposal.

The AEMC may only make the proposed participant derogation if it is satisfied that the participant derogation will or is likely to contribute to the NEO. 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 statements of policy principles.

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<sup>6</sup> Note that SA Power Networks (SAPN) also had a transitional arrangement, and as at the time of lodging this rule change request has been granted leave to appeal (i.e. had satisfied Criteria 1 and 2). We understand that hearings will commence in August 2016 regarding the SAPN merits review application. It is unknown whether the other circumstances (i.e. Criteria 3 to 6) will apply to SA Power Networks and their customers and, if so, whether this is likely to lead to remade determinations in the last year of the current regulatory control period.

The AEMC must also take into account the revenue and pricing principles in the NEL in making the proposed participant derogation, as they relate to distribution system revenue and pricing or regulatory economic methodologies.

Broadly, the revenue and pricing principles are concerned with:

- Allowing distribution and transmission network service providers a reasonable opportunity to at least recover their efficient costs;
- Providing effective incentives to promote efficient investment in transmission and distribution networks;
- Providing certainty with regard to the value of previous investments (in particular the value of the existing regulatory asset bases) providing returns commensurate with the regulatory and commercial risks associated with investment in the transmission and distribution networks; and
- Having regard to the costs and risks associated with under- and over-investment and utilisation of the distribution and transmission networks.

Revenue increments or decrements (as applicable) applied to the AER's efficient revenues in the subsequent regulatory control period are a key feature of the participant derogation in order to manage price shocks to NSW consumers. The impacts on revenues and associated network prices that are set either above efficient levels (leading to inefficient under-utilisation of the network) or below efficient levels (leading to inefficient over-utilisation of the network) in the subsequent regulatory period and the impact of "smoothed" revenues in the last year of the subsequent regulatory period being set materially above (or below) the AER's "unsmoothed revenues have been considered by the NSW DNSPs and are discussed further below.

The NSW DNSPs consider that the proposed derogation contributes to the NEO taking into account the revenue and pricing principles for the reasons set out below.

## 5.1 Minimise price shock

The revenue that the NSW DNSPs are entitled to recover may increase if the 2015 determinations are remade by the AER. The proposed participant derogation will allow for this revenue to be recovered while minimising price shock for NSW consumers. The proposed participant derogation also applies to minimise pricing volatility if revenues decrease in the remade 2015 determinations.

The lessening of price shocks and the associated greater pricing stability ensures that consumers of electricity are given balanced incentives relating to the use of electricity services consistent with the NEO.

In particular, with the remade 2015 determinations and without the proposed participant derogation, NSW consumers may face changes in network charges in the final regulatory year of the current regulatory control period followed by similarly large offsetting changes in network charges in the first year of the subsequent regulatory control period.

The short term variations in price are likely to be caused by the remaking of the 2015 determinations late in the current regulatory control period combined with revenue recovery in the first four years of the period. **The variations in price are not caused by increases in cost** and are likely to lead to inefficient use of electricity and inefficient investment in alternative means of supply or generation, which is contrary to the NEO.

## 5.2 NSW DNSPs can recover revenue that they are entitled to

The proposed participant derogation allows the NSW DNSPs to recover the revenue that they are entitled to collect arising from the remade 2015 determinations.

The remade 2015 determinations must be made by the AER in accordance with the Tribunal's directions and the NEL, and therefore must contribute to the NEO.

It follows that allowing the NSW DNSPs to recover this revenue contributes to the NEO as it will promote the efficient investment in electricity services for the long term benefit of consumers.

### **5.3 Certainty**

The proposed participant derogation provides certainty over both the likely increase in the annual revenue requirements that may occur year-on-year, which will flow through to customer pricing through clause 6.18 and Chapter 6B of the NER and the ability of the NSW DNSPs to recover the revenue that they are entitled to following the AER's remade 2015 determinations.

The increase in regulatory certainty will substantially improve the regulatory regime for consumers and the NSW DNSPs by enabling the NSW DNSPs to invest efficiently in, and consumers to efficiently use, electricity services having regard to the AER's remade 2015 determinations.

### **5.4 Minimised administration costs**

There are limited administration costs from the proposed participant derogation.

The adjustment amount will only be determined if there is an adjustment to be made. The AER will not be required to remake the 2015 determinations if the AER's appeal of the Tribunal's Decision is successful and the proposed participant derogation will have no effect on its terms.

The calculation of the adjustment amount, the expected subsequent adjustment amount and the annual adjustment amount will be undertaken as part of a separate decision to be issued at the same time as the AER's broader process in remaking its 2015 determinations. The information to be included in the allocation amount decision will be available to the AER at the time it remakes the 2015 determinations.

The annual adjustment amount will then flow through to the annual pricing proposals in the current regulatory control period. That is, a new regulatory process is not created by the participant derogation.

The subsequent adjustment amount would be applied as a revenue increment or decrement (as applicable) in the subsequent determination. Again, a new regulatory process is not created by the participant derogation. The ability for the NSW DNSPs to propose a varied adjustment amount does not create a new process, but instead is an additional option in the existing pricing proposal process.

There would be no administration costs associated with the application of the participant derogation to other DNSPs.

### **5.5 Revenues set above or below efficient levels**

The operation of the participant derogation would necessarily result in network revenues being set above the efficient levels determined by the AER in order to recover the adjustment amount in a manner that minimises pricing volatility for NSW consumers.

In the case of a positive adjustment amount, the main impacts arising from revenues and associated network prices that are set above efficient levels for a short period include the potential for lower usage and inefficient under-utilisation of the network, which could lead to:

- Increased uptake of other energy sources (e.g. gas or renewable energy) based on comparisons of network charges that are above efficient levels in the short term;
- The purchase of equipment by customers to avoid higher network costs (e.g. battery storage / load control) based on inefficient short term pricing arrangements could lead to customers not receiving the expected payback on their investment and or the inefficient bypass of the network once prices return to more efficient levels; and
- Future network price increases to meet the requirements of the AER's revenue cap form of price control if the networks are under-utilised.

Conversely, the main impacts arising from revenues and associated with a negative adjustment amount whereby network prices that are set below efficient levels for a short period include the potential for increased usage and inefficient over-utilisation of the network, which could lead to:

- Increased capital investment to meet increased demand growth and corresponding future network price increases for customers;
- Reduced uptake of other energy sources based on inefficient short term price comparisons that may be efficient in the longer term; and
- Customers not investing in equipment (e.g. battery storage / load control) that could otherwise lead to the efficient avoidance of future network charges.

The NSW DNSPs have also considered the impact of "smoothed" revenues in the last year of the subsequent regulatory period being set materially above (or below) the AER's "unsmoothed" revenues and the impact this may have on "inter-period" pricing volatility into the following regulatory period.

In each of the above cases, a balance has been struck between the objectives of minimising pricing volatility and the setting of efficient prices to ensure economic usage decisions.

The NSW DNSPs consider that the proposed participant derogation addresses these concerns in the following ways:

- Allocating the adjustment amount between the current regulatory control period and subsequent regulatory control period on the basis of a five year horizon as the default position is consistent with the "usual" five year regulatory control period and is consistent with incentive elements contained in the regulatory framework (e.g. the five year penalty / reward period for the Efficiency Benefit Sharing Scheme and the Capital Expenditure Sharing Scheme) that may also result in revenue increments or decrements (as applicable) compared to the AER's building block revenues in a given regulatory control period;
- In the absence of the participant derogation, much higher or lower network price changes (as applicable) may occur in the current regulatory control period if the full adjustment amount is recovered over one year (as opposed to a portion of the adjustment amount recovered in that year in the current regulatory control period and the remaining portion of the adjustment amount recovered in the subsequent regulatory control period), which is likely to lead to a greater risk of inefficient usage of the network (higher or lower) and the associated risks and impacts discussed above materialising; and
- Communication of the potential effects of the participant derogation to customers through each business's stakeholder engagement activities and the AEMC's consultation process will assist in alleviating the risks of uneconomic decisions arising from short term pricing arrangements.

Providing a mechanism to minimise pricing volatility by allocating any adjustment amount between the current and subsequent regulatory control periods based on a five year default position with the ability for each NSW DNSP to propose a varied annual adjustment amount is seen by the NSW DNSPs as an appropriate balance between setting a longer recovery period to address the potentially significant short term price shocks that could arise from the AER's remade 2015 determinations and a shorter recovery period to avoid inefficient consumption and usage decisions.

## 6 Expected benefits and costs, and potential impacts of the change

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The expected benefits of the proposed participant derogation are set out in section 5 above. In short, the proposed participant derogation contributes to the NEO by ensuring that the NSW DNSPs can recover the revenue that they are entitled to while also minimising price shock for NSW consumers.

The administrative costs of achieving these benefits as discussed in section 5.4 are limited because the requirements on the AER in the proposed participant derogation are incorporated within existing regulatory processes that will be largely carried out in any event.

## APPENDIX 1

### Proposed participant derogation

#### Part 14 Derogations granted to Ausgrid, Endeavour Energy and Essential Energy

##### 8A.14 Derogation for the current regulatory control period and subsequent regulatory control period to address revenue recovery following the Australian Competition Tribunal's decision

###### 8A.14.1 Overview

- (a) This *participant derogation*, rule 8A.14, provides for:
- (1) the smoothing of the recovery by each NSW DNSP of the difference between the *annual revenue requirements* for each *regulatory year* in the current regulatory control period set out in:
    - A. the 2015 determination; and
    - B. the remade 2015 determination,with such adjustments as may be necessary to best minimise variations of network charges between *regulatory years* and *regulatory control periods*; and
  - (2) if the AER ceases to be under an obligation to remake the 2015 determination, the smoothing of the recovery of the *annual revenue requirements* set out in the 2015 determination by each NSW DNSP taking into account the forecast unders and overs account balance at the end of the fourth *regulatory year* of the current regulatory control period being the *regulatory year* ending on 30 June 2018.
- (b) If the remade 2015 determination is made by the AER prior to 1 March of the penultimate *regulatory year* of the current regulatory control period or the AER ceases to be under an obligation to make the remade 2015 determination, then:
- (1) clause 8A.14.3 will apply; and
  - (2) the smoothing of revenue referred to in clause 8A.14.1(a) will be over:
    - A. each remaining *regulatory year* of the current regulatory control period; and
    - B. the subsequent regulatory control period.
- (c) If the remade 2015 determination is made by the AER on or after 1 March of the penultimate *regulatory year* of the current regulatory control period, then:
- (1) clause 8A.14.4 will apply; and
  - (2) the smoothing of revenue referred to in clause 8A.14.1(a) will be over only the subsequent regulatory control period.
- (d) Definitions for this *participant derogation* are set out in clause 8A.14.5.

###### 8A.14.2 Expiry

This *participant derogation* expires at the end of the subsequent regulatory control period.

### 8A.14.3 Recovery of revenue in the current regulatory control period and subsequent regulatory control period

#### General

- (a) This clause 8A.14.3 applies if:
- (1) the remade 2015 determination is made by the AER prior to the commencement of the final *regulatory year* of the current regulatory control period; or
  - (2) the AER ceases to be under an obligation to make the remade 2015 determination.

#### Determination of adjustment

- (b) At the time of making the remade 2015 determination, the AER must make an adjustment amount allocation determination for each NSW DNSP that satisfies the requirements of clause 8A.14.3(c):
- (c) The adjustment amount allocation determination must determine:
- (1) the adjustment amount for the relevant NSW DNSP;
  - (2) the expected subsequent adjustment amount for the relevant NSW DNSP; and
  - (3) the annual adjustment amount for each remaining regulatory year of the current regulatory control period for the relevant NSW DNSP.
- (d) If the AER ceases to be under an obligation to remake the 2015 determination for a NSW DNSP, then:
- (1) for the avoidance of doubt, the AER is not under an obligation to make an adjustment amount allocation determination for that NSW DNSP; and
  - (2) the adjustment amount, annual adjustment amount and expected subsequent adjustment amount are deemed to be zero for the purposes of this clause 8A.14.3 for that NSW DNSP.

#### Recovery in the current regulatory control period

- (e) A pricing proposal submitted by a NSW DNSP for a *regulatory year* in the current regulatory control period may only seek to recover:
- (1) the *annual revenue requirement* determined in the remade 2015 determination for that *regulatory year*; less
  - (2) the annual adjustment amount or varied annual adjustment amount determined in accordance with clause 8A.14.3(g) for that *regulatory year*.
- (f) A NSW DNSP may propose in a pricing proposal for a *regulatory year* in the current regulatory control period an annual adjustment amount for that *regulatory year* that is different from:
- (1) the annual adjustment amount determined by the AER in its adjustment amount allocation determination; or
  - (2) the deemed annual adjustment amount under clause 8A.14.3(d)(2),
- (as applicable) if the proposed annual adjustment amount would better minimise price variation between *regulatory years* and *regulatory control periods* than the annual adjustment amount referred to in subclauses (1) and (2) taking into account:

- (3) the change in *annual revenue requirements* between the fourth and fifth *regulatory years* of the current regulatory control period ending on 30 June 2018 and 30 June 2019 respectively as a result of the remade 2015 determination;
  - (4) the known and forecast revenues recovered or to be recovered by the relevant NSW DNSP at the time of the remade 2015 determination; and
  - (5) any other relevant factor.
- (g) In determining whether to approve a pricing proposal for a NSW DNSP for a *regulatory year* in the current regulatory control period under clause 6.18, the AER:
- (1) must accept the annual adjustment amount proposed by the NSW DNSP under clause 8A.14.3(f) if it is satisfied that the proposed annual adjustment amount would better minimise variations in network charges between *regulatory years* and *regulatory control periods* for that NSW DNSP's customers than the annual adjustment amount for that *regulatory year* set out in the adjustment amount allocation determination or the deemed annual adjustment amount under clause 8A.14.3(d)(2) (as applicable);
  - (2) may revise the annual adjustment amount proposed by the NSW DNSP under clause 8A.14.3(f) if it is satisfied that the revised adjustment amount would better minimise variations in network charges between *regulatory years* and *regulatory control periods* for that NSW DNSP's customers than the annual adjustment amount proposed by the DNSP, and amount annual adjustment amount for that *regulatory year* set out in the adjustment amount allocation determination or the deemed annual adjustment amount under clause 8A.14.3(d)(2) (as applicable); and
  - (3) may revise the annual adjustment amount if the NSW DNSP has not proposed an adjustment amount under clause 8A.14.3(f) and the AER is satisfied that a revised adjustment amount would better minimise variations in network charges between *regulatory years* and *regulatory control periods* for that NSW DNSP's customers than the annual adjustment amount for that *regulatory year* set out in the adjustment amount allocation determination or the deemed annual adjustment amount under clause 8A.14.3(d)(2) (as applicable),
- taking into account the factors specified in clause 8A.14.3(f)(3) to (5).
- (h) For the purposes of clauses 8A.14.3(e) and 8A14.3(g), Chapter 6 is amended for the remainder of the current regulatory control period as follows:
- (1) each NSW DNSP is not required to comply with clauses 6.18.1A(c) or 6.18.1C to the extent necessary to allow the reduction or increase of the *allowed revenue requirement* by the annual adjustment amount for a *regulatory year* in accordance with clause 8A.14.3(e) or the varied annual adjustment amount for a *regulatory year* in accordance with clause 8A.14.3(g) (as applicable);
  - (2) the reference to 'any applicable distribution determination' in clauses 6.18.2(b)(7), 6.18.2(b)(8), 6.18.8(a)(1) and 6.18.8(c) will be interpreted to mean the remade 2015 determination as adjusted by the annual adjustment amount for each *regulatory year* in accordance with clause 8A.14.3(e) or the varied annual adjustment amount in accordance with clause 8A14.3(g) (as applicable);

- (3) the change to the *annual revenue requirement* by the annual adjustment amount for a *regulatory year* in accordance with clause 8A.14.3(e) or the varied annual adjustment amount for a *regulatory year* in accordance with clause 8A.14.3(g) (as applicable) is deemed to be a permitted variation from the pricing principles set out in clauses 6.18.5(e) to 6.18.5(j);
- (4) the reference to ‘the Distribution Network Service Provider’s annual revenue requirement’ in clause 6.18.7(d)(1) will be interpreted to mean the NSW DNSP’s annual revenue requirement in the remade 2015 determination as adjusted by the annual adjustment amount or the varied annual adjustment amount (as applicable) for the relevant *regulatory year*;
- (5) any variation in proposed tariffs caused by the remade 2015 determination and the change to the *annual revenue requirement* by the annual adjustment amount or the varied annual adjustment amount (as applicable) will be deemed to be explained by this derogation for the purposes of clause 6.18.8(a)(2); and
- (6) if the AER amends a pricing proposal pursuant to clause 6.18.8(b)(2) or 6.18.8(c), then in addition to the requirements in clause 6.18.8(c1), the AER must have regard to:
  - A. any variation in proposed tariffs caused by the remade 2015 determination and the change to the *annual revenue requirement* by the annual adjustment amount or the varied annual adjustment amount (as applicable) pursuant to this derogation; and
  - B. whether the annual adjustment amount or the varied annual adjustment amount (as applicable) in the amended pricing proposal better minimises variations in network charges between *regulatory years* and *regulatory control periods* relative to the pricing proposal submitted by the NSW DNSP,

and all references to these clauses of the NER must be interpreted as references to those provisions as amended by this clause 8A.14.3(h).

- (i) For the purposes of clause 8A.14.3(e) and 8A.14.3(g), for the remainder of the current regulatory control period the reference to ‘a Distribution Network Service Provider’s distribution determination’ in clause 6B.A2.3 will be interpreted to mean the remade 2015 determination as adjusted by the annual adjustment amount or varied annual adjustment amount (as applicable) for the relevant *regulatory year* and all references to clause 6B.A2.3 of the NER must be interpreted as references to that provision as amended by this clause 8A.14.3(h).

#### **Recovery in the subsequent regulatory control period**

- (j) Except as otherwise set out in this clause 8A.14.3, Chapter 6 (other than clause 6.5.9(b)(2)) governs the making of the subsequent determination for each NSW DNSP.
- (k) In each subsequent determination, the AER must:
  - (1) determine the subsequent adjustment amount for each NSW DNSP; and
  - (2) include the subsequent adjustment amount as a revenue increment (if positive) or decrement (if negative) in the building blocks determined under clause 6.4 for the first *regulatory year* of the subsequent regulatory control period.

- (l) The determination by the AER of the subsequent adjustment amount under clause 8A.14.3(k)(1) is taken to be a constituent decision for the purposes of clause 6.12.1 of Chapter 6.

#### **8A.14.4 Recovery of revenue in the subsequent regulatory control period only**

##### **General**

- (a) This clause 8A.14.4 applies if the remade 2015 determination is made by the AER on or after the commencement of the final *regulatory year* of the current regulatory control period.

##### **Determination of the adjustment**

- (b) The AER must:
  - (1) at the time of making the remade 2015 determination for each NSW DNSP, determine the adjustment amount.
  - (2) make or remake the subsequent determination (as applicable) for each NSW DNSP in accordance with clauses 8A.14.4(d) and 8A.14.4(e).
- (c) The determination by the AER of the adjustment amount under clause 8A.14.4(b)(1) is taken to be a constituent decision for the purposes of clause 6.12.1 of Chapter 6.

##### **Recovery in the subsequent regulatory control period**

- (d) Except as otherwise set out in this clause 8A.14.4, Chapter 6 (other than clause 6.5.9(b)(2)) governs the making or remaking of the subsequent determination for each NSW DNSP.
- (e) In the subsequent determination or remade subsequent determination (as applicable), the AER must include the adjustment amount as a revenue increment (if positive) or decrement (if negative) in the building blocks determined under clause 6.4 for the first *regulatory year* of the subsequent regulatory control period that follows the publication of the remade 2015 determination.

#### **8A.14.5 Definitions**

In this *participant derogation*, rule 8A.14:

**2015 determination** means, for each NSW DNSP, each of the following distribution determinations (as applicable):

- (a) the distribution determination for the current regulatory control period published by the AER on 30 April 2015 (as corrected by the AER on 20 May 2015) in respect of Ausgrid;
- (b) the distribution determination for the current regulatory control period published by the AER on 30 April 2015 (as corrected by the AER on 20 May 2015) in respect of Endeavour Energy; and
- (c) the distribution determination for the current regulatory control period published by the AER on 30 April 2015 (as corrected by the AER on 20 May 2015) in respect of Essential Energy.

**adjustment amount**, for each NSW DNSP, means:

- (a) the sum of the *annual revenue requirements* approved by the AER in the remade 2015 determination for each *regulatory year* of the current regulatory control period; less

(b) the sum of the *annual revenue requirements* approved by the AER in the 2015 determination for each *regulatory year* of the current regulatory control period,

subject to such modifications as are necessary to ensure that:

(c) the sum of the sum of the *annual revenue requirements* for each *regulatory year* of the current regulatory control period approved by the AER in the 2015 determination and the adjustment amount,

is equivalent in net present value terms to:

(d) the sum of the *annual revenue requirements* for each *regulatory year* of the current regulatory control period approved by the AER in the remade 2015 determination.

**adjustment amount allocation determination** means the determination made by the AER in accordance with clause 8A.14.3(b).

**annual adjustment amount** means the amount for each *regulatory year* remaining in the current regulatory control period that is equivalent in net present value terms to:

(a) the expected subsequent adjustment amount; divided by

(b) the number of remaining *regulatory years* in the current regulatory control period.

**current regulatory control period** means, for each NSW DNSP, the *regulatory control period* of five years that commenced on 1 July 2014 and ends on 30 June 2019, which includes the transitional regulatory control period and subsequent regulatory control period as those terms are defined in clause 11.55.1.

**expected subsequent adjustment amount** means the amount that it is equivalent in net present value terms to:

(a) the adjustment amount; multiplied by

(b) the factor determined as follows:

(1) five less the number of remaining *regulatory years* in the current regulatory control period; divided by

(2) five.

**NSW DNSP** means each of the following Distribution Network Service Providers:

(a) Ausgrid, the energy services corporation of that name (formerly known as EnergyAustralia), which is constituted under section 7 of the Energy Services Corporations Act 1995 (NSW) and specified in Part 2 of Schedule 1 to that Act, or any successor to its business (including any 'authorised distributor' of Ausgrid's 'network infrastructure assets' (as those terms are defined in the in the Electricity Network Assets (Authorised Transactions) Act 2015 (NSW)) following the transfer of the whole or part of those network infrastructure assets to the private sector);

(b) Endeavour Energy, the energy services corporation of that name (formerly known as Integral Energy), which is constituted under section 7 of the Energy Services Corporations Act 1995 (NSW) and specified in Part 2 of Schedule 1 to that Act, or any successor to its business (including any 'authorised distributor' of Endeavour Energy's 'network infrastructure assets' (as those terms are defined in the in the Electricity Network Assets (Authorised Transactions) Act 2015 (NSW)) following the transfer of the whole or part of those network infrastructure assets to the private sector); and

(c) Essential Energy, the energy services corporation of that name (formerly known as Country Energy), which is constituted under section 7 of the Energy Services Corporations Act 1995 (NSW) and specified in Part 2 of Schedule 1 to that Act, or any successor organisation.

**remade 2015 determination** means, for each NSW DNSP, the 2015 determination of that NSW DNSP as remade by the AER following the Tribunal's decision.

**subsequent adjustment amount** means the amount that is equivalent in net present value terms to the sum of the annual adjustment amounts and/or varied annual adjustment amounts (as applicable) for each relevant *regulatory year* in the current regulatory control period.

**subsequent determination** means, for each NSW DNSP, the distribution determination of that NSW DNSP for the subsequent regulatory control period made by the AER.

**subsequent regulatory control period**, of a NSW DNSP, means the *regulatory control period* for the NSW DNSP that immediately follows the current regulatory control period.

**Tribunal's decision** means the decision of the Australian Competition Tribunal in relation to the 2015 determination of each NSW DNSP delivered on 26 February 2016, as varied or remade as a consequence of a decision of the Federal Court or Australian Competition Tribunal applying the outcome of the judicial review of Australian Competition Tribunal's decision delivered on 26 February 2016.

**varied annual adjustment amount** means an annual adjustment amount accepted or revised by the AER in accordance with clause 8A.14.3(g).

## ATTACHMENT 4

### ActewAGL Distribution's proposed participant derogation showing changes to NSW DNSP's proposed participant derogation

#### Part 145 Derogations granted to ~~Ausgrid, Endeavour Energy and Essential Energy~~ ActewAGL Distribution

8A.145 ~~Derogation for the current regulatory control period and subsequent regulatory control period to~~ provide for price smoothing and address revenue recovery following the Australian Competition Tribunal's decision

##### 8A.145.1 Overview

- (a) This *participant derogation*, rule 8A.145, provides for:
- (1) the smoothing of the recovery by ~~each NSW DNSP~~ ActewAGL Distribution of the difference between ~~the~~ its *annual revenue requirements in respect of distribution standard control services* for each *regulatory year* in the current regulatory ~~control~~ period set out in:
    - A. the 2015 determination; and
    - B. the remade 2015 determination,with such adjustments as may be necessary to best minimise price variations of ~~network charges~~ between *regulatory years* and *regulatory control periods*; and
  - ~~(2)~~ (3) the recovery or imposition of the revenue attributable to the difference between the  $S_t$  factor applicable under the 2015 determination in each of the *regulatory years* of current regulatory period (excluding the transitional regulatory control period) for which there was no pricing proposal that gave effect to the remade 2015 determination and that applicable under the remade 2015 determination; and
  - ~~(2)~~ (3) if the AER ceases ing to be under an obligation to remake the 2015 determination, the smoothing of the recovery of the *annual revenue requirements* set out in the 2015 determination by ~~each NSW DNSP~~ taking into account the forecast unders- and overs account balance at the end of the *fourth regulatory year* of the current regulatory control period being the *regulatory year* ending on 30 June 2018.
- (b) If the remade 2015 determination is made by the AER prior to 1 March of the penultimate *regulatory year* of the current regulatory ~~control~~ period or the AER ceases to be under an obligation to make the remade 2015 determination, then:
- (1) clause 8A.145.3 will apply; and
  - (2) the smoothing of revenue referred to in clause 8A.145.1(a) will be over:
    - A. each remaining *regulatory year* of the current regulatory ~~control~~ period; and
    - B. the subsequent regulatory control period.

- (c) If the remade 2015 determination is made by the AER on or after 1 March of the penultimate *regulatory year* of the current regulatory ~~control~~ period, then:
- (1) clause 8A.145.4 will apply; and
  - (2) ~~the smoothing of revenue referred to in clause 8A.145.1(a) will be over only the subsequent regulatory control period~~ this *participant derogation* provides for the recovery over the subsequent regulatory control period only of:
    - A. the difference between expected revenues in respect of distribution standard control services calculated in accordance with the remade 2015 determination and the 2015 determination derived on the basis of the average annual revenue cap in the remade 2015 determination and forecast demand in the 2015 determination;
    - B. the difference between allowed revenues in respect of *transmission standard control services* calculated in accordance with the remade 2015 determination and the 2015 determination; and
    - C. the difference between the building block revenue requirements for annual metering services set out in, or derived for the purpose of the remade 2015 determination and the 2015 determination.
- (d) Definitions for this *participant derogation* are set out in clause 8A.145.5.

#### **8A.145.2 Expiry**

This *participant derogation* expires at the end of the subsequent regulatory control period.

#### **8A.145.3 Recovery of revenue in the current regulatory ~~control~~ period and subsequent regulatory control period**

##### **General**

- (a) This clause 8A.145.3 applies if:
- (1) the remade 2015 determination is made by the AER prior to ~~the commencement~~ 1 March of the ~~final~~ penultimate *regulatory year* of the current regulatory ~~control~~ period; or
  - (2) the AER ceases to be under an obligation to make the remade 2015 determination.

##### **Determination of adjustments**

- (b) At the time of making the remade 2015 determination, the AER must make an adjustment amount allocation determination for ~~each NSW DNSP~~ ActewAGL Distribution that satisfies the requirements of clause 8A.145.3(c);
- (c) The adjustment amount allocation determination must determine the following for ActewAGL Distribution:
- (1) the distribution adjustment amount ~~for the relevant NSW DNSP~~;
  - (2) the expected subsequent distribution adjustment amount ~~for the relevant NSW DNSP~~; and

- (3) the annual distribution adjustment amount for each remaining *regulatory year* of the current regulatory control period for the relevant NSW DNSP;
  - (4) the  $S_t$  adjustment amount; and
  - (5) the annual  $S_t$  adjustment amount for each remaining *regulatory year* of the current regulatory period.
- (d) If the AER ceases to be under an obligation to remake the 2015 determination for a NSW DNSP ActewAGL Distribution, then:
- (1) for the avoidance of doubt, the AER is not under an obligation to make an adjustment amount allocation determination for that NSW DNSP ActewAGL Distribution; and
  - (2) ~~the adjustment amount, annual, adjustment amount and expected subsequent adjustment amount, each of the adjustment amounts referred to in clause 8A.15.3(c)~~ are deemed to be zero for the purposes of this clause 8A.145.3 ~~for that NSW DNSP.~~

#### Recovery in the current regulatory control period

- (e) For the purposes of Aa pricing proposal submitted by a NSW DNSP ActewAGL Distribution for a *regulatory year* in the current regulatory control period may only seek to recover the value of the average annual revenue cap in year  $t$  ( $AARC_t$ ) must be:
- (1) ~~the annual revenue requirement determined in the remade 2015 determination for that *regulatory year*; less~~
  - (2) reduced or increased by the average annual distribution adjustment amount or average varied annual distribution adjustment amount determined in accordance with clause 8A.145.3(g) for that *regulatory year*; (where that amount is positive or negative respectively); and
  - (2) reduced or increased by the annual  $S_t$  adjustment amount for that *regulatory year* (where that amount is negative or positive respectively).
- (f) A NSW DNSP ActewAGL Distribution may propose in a pricing proposal for a *regulatory year* in the current regulatory control period an annual distribution adjustment amount for that *regulatory year* that is different from:
- (1) the annual distribution adjustment amount determined by the AER in its adjustment amount allocation determination; or
  - (2) the deemed annual distribution adjustment amount under clause 8A.145.3(d)(2), (as applicable) if the proposed annual distribution adjustment amount would better minimise price variation between *regulatory years* and *regulatory control periods* than the annual distribution adjustment amount referred to in subclauses (1) ~~and~~ (2) taking into account:
  - (3) the change in ~~annual revenue requirements~~ the revenue allowance for distribution standard control services between the fourth and fifth *regulatory years* of the current regulatory control period ending on 30 June 2018 and 30 June 2019 respectively as a result of the remade 2015 determination;

- (4) the known and forecast revenues recovered or to be recovered by ~~the relevant NSW DNSP~~ActewAGL Distribution at the time of the remade 2015 determination; and
- (5) any other relevant factor.
- (g) In determining whether to approve a pricing proposal for ~~a NSW DNSP~~ActewAGL Distribution for a *regulatory year* in the current regulatory ~~control~~ period under clause 6.18, the AER:
- (1) must accept the annual distribution adjustment amount proposed by ~~the NSW-DNSP~~ActewAGL Distribution under clause 8A.145.3(f) if it is satisfied that the proposed annual distribution adjustment amount would better minimise price variations in network charges between *regulatory years* and *regulatory control periods* for ~~that NSW DNSP's~~ActewAGL Distribution's customers than the annual distribution adjustment amount for that *regulatory year* set out in the adjustment amount allocation determination or the deemed annual distribution adjustment amount under clause 8A.145.3(d)(2) (as applicable);
- (2) may revise the annual distribution adjustment amount proposed by ~~the NSW-DNSP~~ActewAGL Distribution under clause 8A.145.3(f) if it is satisfied that the revised adjustment amount would better minimise price variations in network charges between *regulatory years* and *regulatory control periods* for ~~that NSW-DNSP's~~ActewAGL Distribution's customers than:
- A. the annual distribution adjustment amount proposed by ~~the DNSP~~ActewAGL Distribution; and
- B. ~~either the amount~~ annual distribution adjustment amount for that *regulatory year* set out in the adjustment amount allocation determination or the deemed annual distribution adjustment amount under clause 8A.145.3(d)(2) (as applicable); and
- (3) may revise the annual distribution adjustment amount if ~~the NSW-DNSP~~ActewAGL Distribution has not proposed an adjustment amount under clause 8A.145.3(f) and the AER is satisfied that a revised adjustment amount would better minimise price variations in network charges between *regulatory years* and *regulatory control periods* for ~~that NSW DNSP's~~ActewAGL Distribution's customers than the annual distribution adjustment amount for that *regulatory year* set out in the adjustment amount allocation determination or the deemed annual distribution adjustment amount under clause 8A.145.3(d)(2) (as applicable),
- taking into account the factors specified in clause 8A.145.3(f)(3) to (5).
- (h) For the purposes of clauses 8A.145.3(e), ~~8A.15.3(f)~~ and 8A.145.3(g), Chapter 6 is amended for the remainder of the current regulatory ~~control~~ period as follows:
- (1) ~~each NSW-DNSP~~ActewAGL Distribution is not required to comply with clauses 6.18.1A(c) or 6.18.1C to the extent necessary to allow the reduction or increase of the ~~allowed revenue requirement~~average annual revenue cap (AARC) in accordance with clause 8A.15.3(e) by the average annual distribution adjustment amount for a *regulatory year* ~~in accordance with clause 8A.145.3(e)~~ or the average

varied annual distribution adjustment amount for a *regulatory year* ~~in accordance with clause 8A.145.3(g) (as applicable), and the annual  $S_t$  adjustment amount;~~

- (2) the reference to ‘any applicable distribution determination’ in clauses 6.18.2(b)(7), 6.18.2(b)(8), 6.18.8(a)(1) and 6.18.8(c) will be interpreted to mean the remade 2015 determination as adjusted in accordance with clause 8A.15.3(e) by the average annual distribution adjustment amount for each *regulatory year* ~~in accordance with clause 8A.145.3(e) or the average varied annual distribution adjustment amount in accordance with clause 8A.145.3(g) (as applicable), and the annual  $S_t$  adjustment amount;~~
- (3) the change to the ~~*annual revenue requirement*~~average annual revenue cap (AARC<sub>t</sub>) in accordance with clause 8A.15.3(e) by the average annual distribution adjustment amount for a *regulatory year* ~~in accordance with clause 8A.145.3(e) or the average varied annual distribution adjustment amount for a *regulatory year* ~~in accordance with clause 8A.145.3(g) (as applicable) and the annual  $S_t$  adjustment amount~~ is deemed to be a permitted variation from the pricing principles set out in clauses 6.18.5(e) to 6.18.5(j);~~
- (4) ~~the reference to ‘the Distribution Network Service Provider’s annual revenue requirement’ in clause 6.18.7(d)(1) will be interpreted to mean the NSW DNSP’s annual revenue requirement in the remade 2015 determination as adjusted by the annual adjustment amount or the varied annual adjustment amount (as applicable) for the relevant *regulatory year*; clause 6.18.6 does not apply;~~
- (5) any variation in proposed tariffs caused by the remade 2015 determination and the change to the ~~*annual revenue requirement*~~average annual revenue cap (AARC<sub>t</sub>) by the average annual distribution adjustment amount or the average varied annual distribution adjustment amount (as applicable) and the annual  $S_t$  adjustment amount will be deemed to be explained by this derogation for the purposes of clause 6.18.8(a)(2); and
- (6) if the AER amends a pricing proposal pursuant to clause 6.18.8(b)(2) or 6.18.8(c), then in addition to the requirements in clause 6.18.8(c1), the AER must have regard to:
  - A. any variation in proposed tariffs caused by the remade 2015 determination ~~and;~~
  - B. the change to the ~~*annual revenue requirement*~~average annual revenue cap (AARC<sub>t</sub>) by the average annual distribution adjustment amount or the average varied annual distribution adjustment amount (as applicable) and the annual  $S_t$  adjustment amount pursuant to this derogation; and
  - BC. whether the average annual distribution adjustment amount or the average varied annual distribution adjustment amount (as applicable) in the amended pricing proposal better minimises price variations ~~in network charges~~ between *regulatory years* and *regulatory control periods* relative to the pricing proposal submitted by ~~the NSW DNSP~~ActewAGL Distribution,and all references in the Rules to these clauses of the ~~NER~~Rules referred to in (h)(1) to (6) above must be interpreted as references to those provisions as amended by this clause 8A.145.3(h).

(i) ~~For the purposes of clause 8A.14.3(e) and 8A.14.3(g), for the remainder of the current regulatory control period the reference to ‘a Distribution Network Service Provider’s distribution determination’ in clause 6B.A2.3 will be interpreted to mean the remade 2015 determination as adjusted by the annual adjustment amount or varied annual adjustment amount (as applicable) for the relevant *regulatory year* and all references to clause 6B.A2.3 of the NER must be interpreted as references to that provision as amended by this clause 8A.14.3(h).~~

(i) If the remade 2015 determination is published on or after 1 March of the penultimate regulatory year of the current regulatory period, that remade 2015 determination must be disregarded in applying the provisions of Part I of Chapter 6 as it applies in the current regulatory period.

### **Recovery in the subsequent regulatory control period**

(j) Except as otherwise set out in this clause 8A.145.3, Chapter 6 (other than clause 6.5.9(b)(2)) governs the making of the subsequent determination for ~~each NSW DNSP~~ActewAGL Distribution.

(k) In each subsequent determination, the AER must:

(1) determine the subsequent distribution adjustment amount for ~~each NSW DNSP~~ActewAGL Distribution; and

(2) include the subsequent distribution adjustment amount as a revenue increment (if positive) or decrement (if negative) in the building blocks determined under clause 6.4 for the first *regulatory year* of the subsequent regulatory control period.

(l) The determination by the AER of the subsequent distribution adjustment amount under clause 8A.145.3(k)(1) is taken to be a constituent decision for the purposes of clause 6.12.1 of Chapter 6.

### **8A.145.4 Recovery of revenue in the subsequent regulatory control period only**

#### **General**

(a) This clause 8A.145.4 applies if the remade 2015 determination is made by the AER on or after ~~the commencement~~ 1 March of the ~~final~~penultimate *regulatory year* of the current regulatory ~~control~~ period.

#### **Determination of the adjustment**

(b) The AER must:

(1) at the time of making the remade 2015 determination for ~~each NSW DNSP~~ActewAGL Distribution, determine the SRCP distribution adjustment amount, the transmission adjustment amount and the metering adjustment amount; and

(2) make or remake the subsequent determination (as applicable) for ~~each NSW DNSP~~ActewAGL Distribution in accordance with clauses 8A.145.4(d) and 8A.145.4(e).

(c) The determinations by the AER of the SRCP distribution adjustment amount, the transmission adjustment amount and the metering adjustment amount under clause

8A.145.4(b)(1) ~~is~~ taken to be a constituent decision for the purposes of clause 6.12.1 of Chapter 6.

### Recovery in the subsequent regulatory control period

- (d) Except as otherwise set out in this clause 8A.145.4, Chapter 6 (other than clause 6.5.9(b)(2)) governs the making or remaking of the subsequent determination for ~~each NSW DNSP ActewAGL Distribution~~.
- (e) In the subsequent determination or remade subsequent determination (as applicable), the AER must:
- (1) ~~include the SRCP distribution adjustment amount and the transmission adjustment amount as a revenue increments (if positive) or decrements (if negative) in the building blocks determined under clause 6.4 for the first regulatory year of the subsequent regulatory control period that follows the publication of the remade 2015 determination; and~~
  - (2) ~~include the metering adjustment amount as a revenue increment (if positive) or decrement (if negative) in the building block revenue requirement for annual metering services for the first regulatory year of the subsequent regulatory control period that follows the publication of the remade 2015 determination.~~

### 8A.145.5 Definitions

In this *participant derogation*, rule 8A.145:

**2015 determination** means ~~the distribution determination for the current regulatory period published by the AER on 30 April 2015 in respect of ActewAGL Distribution, for each NSW DNSP ActewAGL Distribution, each of the following distribution determinations (as applicable):~~

- (a) ~~the distribution determination for the current regulatory control period published by the AER on 30 April 2015 (as corrected by the AER on 20 May 2015) in respect of Ausgrid;~~
- (b) ~~the distribution determination for the current regulatory control period published by the AER on 30 April 2015 (as corrected by the AER on 20 May 2015) in respect of Endeavour Energy; and~~
- (c) ~~the distribution determination for the current regulatory control period published by the AER on 30 April 2015 (as corrected by the AER on 20 May 2015) in respect of Essential Energy.~~

**ActewAGL Distribution** means ~~the Registered Participant that is registered by AEMO as a Network Service Provider in accordance with section 12(1) of the National Electricity Law and clause 2.5.1 of the Rules to own, control and operate the electricity distribution system located in the Australian Capital Territory.~~

**adjustment amount allocation determination** means the determination made by the AER in accordance with clause 8A.145.3(b).

**annual distribution adjustment amount** means the amount for each *regulatory year* remaining in the current regulatory ~~control~~ period that is equivalent in net present value terms to:

- (a) the expected subsequent distribution adjustment amount; divided by
- (b) the number of remaining *regulatory years* in the current regulatory ~~control~~ period.

**annual metering services** means the type 5 and 6 metering services classified as alternative control services, and in respect of which annual metering service charges were specified in the 2015 determination.

**annual  $S_t$  adjustment amount** means the amount for each *regulatory year* remaining in the current regulatory period that is equivalent in net present value terms to:

- (a) the  $S_t$  adjustment amount; divided by
- (b) the number of remaining *regulatory years* in the current regulatory period.

**average annual distribution adjustment amount** means in respect of a *regulatory year* of the current regulatory period, the annual distribution adjustment amount divided by the forecast total kWh for that *regulatory year* in the remade 2015 determination

**average varied annual distribution adjustment amount** means, in respect of a *regulatory year* of the current regulatory period, the varied annual distribution adjustment amount divided by the forecast total kWh for that *regulatory year* in the remade 2015 determination.

**current regulatory control period** means, for each NSW DNSP, the regulatory control period of five years that commenced on 1 July 2014 and ends on 30 June 2019, which includes the 'transitional regulatory control period' and 'subsequent regulatory control period' as those terms are defined in clause 11.55.1 of the *Rules*.

**distribution adjustment amount**, for each NSW DNSP, means:

- (a) the sum of the *annual revenue requirements* for distribution standard control services approved by the AER in the remade 2015 determination for each *regulatory year* of the current regulatory control period; less
- (b) the sum of the *annual revenue requirements* for distribution standard control services approved by the AER in the 2015 determination for each *regulatory year* of the current regulatory control period,

subject to such modifications as are necessary to ensure that:

- (c) ~~the sum of the sum of the *annual revenue requirements* for each *regulatory year* of the current regulatory control period approved by the AER in the 2015 determination~~ amount referred to in paragraph (b) of this definition and the distribution adjustment amount,

is equivalent in net present value terms to:

- (d) ~~the amount referred to in paragraph (a) of this definition~~ sum of the *annual revenue requirements* for each *regulatory year* of the current regulatory control period approved by the AER in the remade 2015 determination.

**distribution standard control services** means *standard control services* other than *transmission standard control services*.

**expected subsequent distribution adjustment amount** means the amount that it is equivalent in net present value terms to:

- (a) the distribution adjustment amount; multiplied by
- (b) the factor determined as follows:
  - (1) five less the number of remaining *regulatory years* in the current regulatory control period; divided by
  - (2) five.

**NSW DNSP** means each of the following Distribution Network Service Providers:

- (a) ~~Ausgrid, the energy services corporation of that name (formerly known as EnergyAustralia), which is constituted under section 7 of the Energy Services Corporations Act 1995 (NSW) and specified in Part 2 of Schedule 1 to that Act, or any successor to its business (including any ‘authorised distributor’ of Ausgrid’s ‘network infrastructure assets’ (as those terms are defined in the in the Electricity Network Assets (Authorised Transactions) Act 2015 (NSW)) following the transfer of the whole or part of those network infrastructure assets to the private sector);~~
- (b) ~~Endeavour Energy, the energy services corporation of that name (formerly known as Integral Energy), which is constituted under section 7 of the Energy Services Corporations Act 1995 (NSW) and specified in Part 2 of Schedule 1 to that Act, or any successor to its business (including any ‘authorised distributor’ of Endeavour Energy’s ‘network infrastructure assets’ (as those terms are defined in the in the Electricity Network Assets (Authorised Transactions) Act 2015 (NSW)) following the transfer of the whole or part of those network infrastructure assets to the private sector); and~~
- (c) ~~Essential Energy, the energy services corporation of that name (formerly known as Country Energy), which is constituted under section 7 of the Energy Services Corporations Act 1995 (NSW) and specified in Part 2 of Schedule 1 to that Act, or any successor organisation.~~

**metering adjustment amount** means:

- (a) the sum of the building block revenue requirements for annual metering services for each regulatory year of the current regulatory period set out in or derived for the purpose of the remade 2015 determination; less
- (b) the sum of the building block revenue requirements for annual metering services for each regulatory year of the current regulatory period set out in or derived for the purpose of the 2015 determination,

subject to such modifications as are necessary to ensure that:

- (c) the sum of the amount referred to in paragraph (b) of this definition and the metering adjustment amount,

is equivalent in net present value terms to:

- (d) the amount referred to in paragraph (a) of this definition.

**remade 2015 determination** means, for each NSW DNSP, the 2015 determination of ~~that NSW DNSP~~ ActewAGL Distribution as remade by the AER following the Tribunal’s decision.

**S<sub>i</sub> adjustment amount** means the amount that is equivalent in net present value terms to the sum of:

- (a) the S<sub>i</sub> factor calculated in accordance with the remade 2015 determination; multiplied by
- (b) the forecast total kWh as set out in the 2015 determination,

for each of the regulatory years of the current regulatory period (excluding the transitional regulatory control period) for which there was no pricing proposal that gave effect to the remade 2015 determination.

**SRCP distribution adjustment amount** means:

- (a) the sum of:
  - (1) the value of the average annual revenue cap (AARC<sub>i</sub>) calculated in accordance with the remade 2015 determination; multiplied by
  - (2) the forecast total kWh as set out in the 2015 determination,

for each *regulatory year* of the current regulatory period (excluding the transitional regulatory control period); less

(b) the sum of:

(1) the value of the average annual revenue cap (AARC<sub>i</sub>) calculated in accordance with the 2015 determination; multiplied by

(2) the forecast total kWh as set out in the 2015 determination,

for each *regulatory year* of the current regulatory period (excluding the transitional regulatory control period),

subject to such modifications as are necessary to ensure that:

(c) the sum of the amount referred to in paragraph (b) of this definition and the SRCP distribution adjustment amount.

is equivalent in net present value terms to:

(d) the amount referred to in paragraph (a) of this definition.

**subsequent distribution adjustment amount** means the amount that is equivalent in net present value terms to the sum of the annual distribution adjustment amounts and/or varied annual distribution adjustment amounts (as applicable) for each relevant *regulatory year* in the current regulatory ~~control~~ period.

**subsequent determination** means, ~~for each NSW DNSP, the~~ ActewAGL Distribution's distribution determination ~~of that NSW DNSP~~ for the subsequent regulatory control period made by the AER.

**subsequent regulatory control period**, ~~of a NSW DNSP,~~ means the *regulatory control period* for ~~the NSW DNSP~~ ActewAGL Distribution that immediately follows the current regulatory ~~control~~ period.

**transitional regulatory control period** has the meaning in clause 11.55.1 of the *Rules* being a period of one year that commences on 1 July 2014 and ends on 30 June 2015.

**transmission adjustment amount** means:

(a) the sum of the value of the MAR<sub>i</sub> for *transmission standard control services* for each *regulatory year* of the current regulatory period (excluding the transitional regulatory control period) calculated in accordance with the remade 2015 determination; less

(b) the sum of the value of the MAR<sub>i</sub> for *transmission standard control services* for each *regulatory year* of the current regulatory period (excluding the transitional regulatory control period) calculated in accordance with the 2015 determination,

subject to such modifications as are necessary to ensure that:

(c) the sum of the amount referred to in paragraph (b) of this definition and the transmission adjustment amount.

is equivalent in net present value terms to:

(d) the amount referred to in paragraph (a) of this definition.

**Tribunal's decision** means the decision of the Australian Competition Tribunal in relation to ~~the~~ ActewAGL Distribution's 2015 determination ~~of each NSW DNSP~~ delivered on 26 February 2016, as varied or remade as a consequence of a decision of the Federal Court or Australian Competition Tribunal applying the outcome of the judicial review of the Australian Competition Tribunal's decision delivered on 26 February 2016.

**varied annual distribution adjustment amount** means an annual distribution adjustment amount accepted or revised by the AER in accordance with clause 8A.145.3(g).

## ATTACHMENT 5

### Explanation of key amendments to the NSW DNSPs' proposed participant derogation

The following table describes the key amendments ActewAGL has made to the NSW DNSPs' proposed participant derogation. Generally, ActewAGL has not sought to describe amendments relating to changes concerned with making the derogation applicable to it (eg. the replacement of references to NSW DNSPs with a reference to ActewAGL).

Clause NNSW derogation	Clause ActewAGL derogation	Amendment	Explanation
8A.14.5 Definition of 'current regulatory control period'	8A.15.5 Definition of 'current regulatory period'	ActewAGL has revised the defined term 'current regulatory control period' in the NSW DNSPs' proposed participant derogation to be 'current regulatory period' and made corresponding amendments where that term is referred to in the derogation.	The term 'current regulatory control period' is used in the NSW DNSPs' proposed participant derogation to refer to the period of five years that commenced on 1 July 2014 and ends on 30 June 2019, which includes the 'transitional regulatory control period' and the 'subsequent regulatory control period' as those terms are defined in clause 11.55.1 of the NER. Each of the 'transitional regulatory control period' and the 'subsequent regulatory control period' are 'regulatory control periods' for the purposes of the NER but the five year period comprised of the 'transitional regulatory control period' and the 'subsequent regulatory control period' is not (clause 11.55.1 definition of 'subsequent regulatory control period', clause 11.56.3(a)(2) and clause 11.56.4(g) and (k)) ActewAGL has revised the term used to refer to that five year period to the 'current regulatory period' since that period is not a regulatory control period.
8A.14.1(a)(1)	8A.15.1(a)(1)  New definition for 'distribution standard control services', revised definitions of 'distribution adjustment amount', 'annual distribution adjustment amount',	ActewAGL has amended this clause and related definitions to refer to the annual revenue requirements in respect of distribution standard control services.	ActewAGL has dual function assets, being high voltage transmission assets within its distribution network. As a result, in its 2015 determination, the AER determined annual revenue requirements in respect of its distribution standard control services and its transmission standard control services. Accordingly, ActewAGL has sought to clarify in the derogation where the provisions of the derogation concern revenue in respect of its distribution standard control services.

Clause NSW derogation	Clause ActewAGL derogation	Amendment	Explanation
	'expected distribution amount' and 'subsequent distribution adjustment amount'		
8A.14.1(a)(1), 8A.14.3(g)(1), (g)(2), (g)(3), (h)(6) and (i)	8A.15.1(a)(1), 8A.15.3(g)(1), (g)(2), (g)(3), (h)(6)	<p>ActewAGL has removed the reference to 'network charges' in clauses 8A.15.1(a)(1), 8A.15.3(g)(1), (g)(2), (g)(3) and (h)(6).</p> <p>ActewAGL has removed what was clause 8A.14.3(i) in the NSW DNSPs' derogation which sought to vary clause 6B.A2.3 in Chapter 6B of the NER.</p>	<p>Chapter 10 of the NER provides that 'network charges' has (in the context of Chapter 6B) the meaning given in clause 6B.A1.2, which in turn defines 'network charges' as charges that a DNSP is entitled to claim for customer connection services in respect of shared customers under the NER. These charges are distinct from the network use of system charges (NUOS) that are relevant to the derogation. Accordingly, the use of the term 'network charges' in the derogation may be confusing.</p> <p>Clause 8A.14.3(i) in the NSW DNSPs' derogation sought to vary clause 6B.A2.3 in Chapter 6B of the NER. Clause 6B.A2.3 provides that network charges must be calculated in accordance with the NER and a DNSP's distribution determination. Since clause 6B.A2.3 concerns 'network charges' under Chapter 6B of the NER, rather than DUOS charges, it is not relevant to the derogation. Accordingly, it is unnecessary to vary its operation under the derogation.</p>
8A.14.1(a)(2)	8A.15.1(a)(3)	ActewAGL has removed the reference to the unders and overs account in this clause in the Overview.	Under the 2015 determination, ActewAGL operates under a different form of control (an average revenue control) to the NSW DNSPs (a revenue control). As a result, unlike NSW DNSPs, ActewAGL does not have an unders and overs account as part of its control mechanism. Despite this, the derogation can operate with respect to ActewAGL in a similar manner to the NSW DNSPs in circumstances where the AER is not required to remake its 2015 determination.

Clause NSW derogation	Clause ActewAGL derogation	Amendment	Explanation
8A.14.3(a) and 8A.14.4(a)	8A.15.3(a) and 8A.15.4(a)	ActewAGL has amended these clauses to specify the timing for the operation of clauses 8A.15.3 and 8A.15.4 by reference to 1 March of the penultimate year of the current regulatory period rather than the commencement of the final year of that period.	ActewAGL understands from clause 8A.14.1(b) and (c) of the NSW DNSPs' derogation that this is their intent. However, by oversight, in finalising the derogation it appears that they have omitted to reflect this intent in clauses 8A.14.3(a) and 8A.14.4(a) of the derogation.
8A.14.3(c)	8A.15.1(a)(2) 8A.15.3(c)  New definitions for 'S <sub>t</sub> adjustment amount' and 'annual S <sub>t</sub> adjustment amount'	ActewAGL has amended clause 8A.15.3(c) to provide that the adjustment amount allocation determination must also determine: <ul style="list-style-type: none"> <li>the S<sub>t</sub> adjustment amount; and</li> <li>the annual S<sub>t</sub> adjustment amount for each remaining year of the current regulatory period.</li> </ul> ActewAGL has included new clause 8A.15.1(a)(2) to refer to the S <sub>t</sub> adjustment in the Overview to the derogation.	Unlike the NSW DNSPs, the Tribunal's decision in respect of ActewAGL contemplates that there could be a change in ActewAGL's service target performance incentive scheme (STPIS) in the remade 2015 determination. In those circumstances, the difference between the annual revenue requirements for distribution standard control services in the 2015 determination and the remade 2015 determination may not be sufficient to compensate ActewAGL. Accordingly, ActewAGL has made amendments to the derogation to allow for the recovery or imposition of the revenue attributable to the difference between the S <sub>t</sub> factor applicable under the 2015 determination in each of the regulatory years of the current regulatory period (excluding the transitional regulatory control period) for which there was no pricing proposal that gave effect to the remade 2015 determination and that applicable under the remade 2015 determination. ActewAGL has not amended the derogation to provide for variation of the annual S <sub>t</sub> adjustment amount because, if necessary, any adjustments required to minimise price variation between regulatory years and regulatory control periods having regard to the annual S <sub>t</sub> adjustment amount could be made through the varied annual distribution adjustment amount.
8A.14.3(e)	8A.15.3(e)  New definitions for 'average annual distribution adjustment amount' and	ActewAGL has amended this clause to provide that for the purposes of a pricing proposal submitted by it for a regulatory year in the current regulatory period the value of the average annual	The use of the term 'annual revenue requirement' in this clause would result in potential under-recovery by ActewAGL in circumstances where the smoothed revenues for the remaining years of the current regulatory period determined in the remade 2015 determination are expected to be higher than the annual revenue requirements for those

Clause NSW derogation	Clause ActewAGL derogation	Amendment	Explanation
	'average varied annual distribution adjustment amount'	<p>revenue cap in year t (<math>AARC_t</math>) must be:</p> <ul style="list-style-type: none"> <li>reduced or increased by the average annual distribution adjustment amount or average varied annual distribution adjustment amount for that regulatory year (where that amount is positive or negative respectively); and</li> <li>reduced or increased by the annual <math>S_t</math> adjustment amount for that regulatory year (where that amount is negative or positive respectively).</li> </ul>	<p>years.</p> <p>Since the purpose of the derogation is to smooth the recovery of the differential in the total annual revenue requirements under the original 2015 determination and remade 2015 determination across the remaining years of the current regulatory period and into the subsequent regulatory control period, the calculation in clause 8A.15.3(e) would be incorrect and would not achieve this purpose if it provided that a DNSP was restricted to recovering its annual revenue requirement for distribution standard control services less the annual distribution adjustment amount or varied annual distribution adjustment amount. This is because the annual revenue requirement for the relevant regulatory year determined in the remade 2015 determination will be a revenue amount prior to any adjustments made having regard to the differential between the total annual revenue requirements under the 2015 determination and remade 2015 determination.</p> <p>Further, under the control mechanism applicable to ActewAGL, ActewAGL is not entitled to recover its annual revenue requirement for the relevant regulatory year, but rather is entitled to recover its average annual revenue cap for the year (<math>AARC_t</math>).</p> <p>On the basis that the adjustment to ActewAGL's control mechanism to provide for the annual distribution adjustment amount would be made by making an adjustment to the average annual revenue cap in year t (<math>AARC_t</math>), it is also necessary to average the annual distribution adjustment amount across forecast demand for the relevant regulatory year. Accordingly, ActewAGL has included definitions of 'average annual distribution adjustment amount' and 'average varied distribution adjustment amount' to provide for this and applied those terms in clauses 8A.15.3(e)(1) and 8A.15.3(h)(1), (2), (3), (5) and (6).</p>

Clause NSW derogation	Clause ActewAGL derogation	Amendment	Explanation
			As noted above, ActewAGL also amended this clause of the derogation to allow for the recovery/imposition of the revenue attributable to the difference between the $S_t$ factor applicable under the 2015 determination in each of the regulatory years of the current regulatory period (excluding the transitional regulatory control period) for which there was no pricing proposal that gave effect to the remade 2015 determination and that applicable under the remade 2015 determination.
8A.14.3(h)(1), (2), (3), (5) and (6)	8A.15.3(h)(1), (2), (3), (5) and (6)	<p>ActewAGL has amended these clauses to replace references to 'annual revenue requirement' with 'average annual revenue cap (AARC<sub>t</sub>)' and references to 'annual adjustment amount' and 'varied annual adjustment amount' with 'average annual distribution adjustment amount' and 'average varied annual distribution adjustment amount', respectively. In addition, ActewAGL has included references to the 'annual <math>S_t</math> adjustment amount'.</p> <p>ActewAGL notes that clause 8A.14.3(h)(1) of the NSW DNSPs' derogation refers to 'allowed revenue requirement' instead of 'annual revenue requirement', however, ActewAGL understands this to be a typographical error.</p>	ActewAGL has amended these clauses for the same reasons discussed in the above row, namely that the relevant adjustment in the current regulatory period under the derogation should be an adjustment to the average annual revenue cap (AARC <sub>t</sub> ) by the average annual distribution adjustment amount (or average varied annual distribution adjustment amount), rather than an adjustment to the annual revenue requirement. In addition, ActewAGL has included references to the 'annual $S_t$ adjustment amount' in these clauses because its proposed participant derogation includes an adjustment to the average annual revenue cap (AARC <sub>t</sub> ) for the 'annual $S_t$ adjustment amount' in the annual pricing proposal process in the current regulatory period. Accordingly, ActewAGL has sought to modify the pricing proposal provisions referred to in clause 8A.15.3(h) having regard to this additional adjustment.
8A.14.3(h)(4)	8A.15.3(h)(4)	<p>ActewAGL has deleted the modification of clause 6.18.7(d)(1) in clause 8A.14.3(h)(4) of the NSW DNSPs' derogation.</p> <p>Instead ActewAGL's clause 8A.15.3(h)(4) provides that for the purposes of clauses 8A.15.3(e), 8A.15.3(f) and 8A.15.3(g) the side</p>	In clause 8A.14.3(h)(4) of their derogation, the NSW DNSPs vary the operation of clause 6.18.7(d)(1) of the NER for the purposes of clauses 8A.14.3(e) and 8A.14.3(g) of the derogation. Clause 6.18.7(d)(1) of the NER provides that a DNSP may not recover designated pricing proposal charges under that clause to the extent the charges are recovered through the DNSP's annual revenue requirement. The derogation has no bearing on the operation of this clause and vice versa. Accordingly,

Clause NSW derogation	Clause ActewAGL derogation	Amendment	Explanation
		constraint in clause 6.18.6 of the NER does not apply.	<p>ActewAGL does consider it necessary to vary its operation in its derogation.</p> <p>As noted in the adjacent column, in clause 8A.15.3(h)(4) ActewAGL has included a provision to the effect that for the purposes of clauses 8A.15.3(e), 8A.15.3(f) and 8A.15.3(g) of the derogation, ActewAGL is not required to comply with the side constraint in clause 6.18.6 of the NER. ActewAGL considers that the operation of the side constraint is unnecessary because the derogation is aimed at minimising price volatility between regulatory years, which is also the premise of the side constraint. Also its operation may be problematic in circumstances where the AER remakes its 2015 determination in the current regulatory period, given the potential for pricing to vary in the remaining year(s) of that period from pricing in the years of the period prior to the remade determination (and perhaps even within the remaining year(s) of that period) in a manner that is not permitted by the side constraint, even with the application of the derogation.</p>
	new clause 8A.15.3(i)	ActewAGL proposes a new clause 8A.15.3(i) to provide that if the remade 2015 determination is published on or after 1 March of the penultimate regulatory year of the current regulatory period, that remade 2015 determination must be disregarded in applying the provisions of Part I of Chapter 6 as it applies in the current regulatory period.	<p>ActewAGL proposes this clause in case the AER remakes its 2015 determination on or after 1 March of the penultimate regulatory year of the current regulatory period but before the AER approves the pricing proposal for the final year of that regulatory control period. In those circumstances, there may be a disconnect between the operation of the derogation (which provides for the adjustment amount to be wholly recovered in the subsequent regulatory control period), and the operation of Part I of Chapter 6 in tandem with the remade 2015 determination.</p> <p>ActewAGL understands new clause 8A.15.3(i) to be consistent with the intent of the NSW DNSPs' derogation.</p>
8A.14.1(c),	8A.15.1(c), 8A.15.4(b)(1),	ActewAGL has amended these clauses and the	In circumstances where the AER remakes its 2015 determination on or

Clause NSW derogation	Clause ActewAGL derogation	Amendment	Explanation
8A.14.4(b)(1), (c) and (e)	(c) and (e)  New definitions for 'SRCP distribution adjustment amount', 'transmission adjustment amount' and 'metering adjustment amount'	<p>associated definitions to provide for the following in circumstances where the AER remakes its 2015 determination on or after 1 March 2018:-</p> <ul style="list-style-type: none"> <li>the amount to be recovered in respect of distribution standard control services in the subsequent regulatory control period to be defined in terms of the difference between (1) the sum of the value of the average annual revenue cap (AARC<sub>t</sub>) for each regulatory year of the current regulatory period calculated in accordance with the remade 2015 determination, multiplied by the forecast total kWh for the relevant regulatory year as set out in the 2015 determination; and (2) the sum of the value of the average value of the average annual revenue cap (AARC<sub>t</sub>) for each regulatory year of the current regulatory period calculated in accordance with the 2015 determination, multiplied by the forecast total kWh for the relevant regulatory year as set out in the 2015 determination; and</li> <li>the recovery of the difference between allowable revenues under the 2015 determination and the remade 2015 determination in respect of transmission standard control services and annual metering services in the subsequent regulatory control period.</li> </ul>	<p>after 1 March 2018, ActewAGL has sought to specify an adjustment amount for distribution standard control services which, having regard to its control mechanism and the potential for there to be change in ActewAGL's STPIS in the remade 2015 determination, will come close to enabling ActewAGL to recover (to the extent possible) the revenue impact of the remade 2015 determination. In circumstances where the Tribunal's decision in respect of ActewAGL contemplates that there could be a change in ActewAGL's STPIS in the remade 2015 determination, the difference between the annual revenue requirements in the 2015 determination and the remade 2015 determination may not be sufficient to compensate ActewAGL. Accordingly, ActewAGL has specified the adjustment amount in clause 8A.15.4 by reference to the differential in allowable revenue under its control mechanism calculated in accordance with the remade 2015 determination and the 2015 determination on the basis that demand is as forecast in the 2015 determination. This is consistent with ActewAGL's form of control, pursuant to which ActewAGL, and not consumers, bears the demand risk.</p> <p>Having regard to the Tribunal's decision in respect of ActewAGL, the remade 2015 determination could also result in different revenue allowances in respect of transmission standard control services and annual metering services than those under the 2015 determination. Accordingly, ActewAGL has made provision in the derogation for the recovery of the difference between allowed revenues under the 2015 determination and the remade 2015 determination in respect of both transmission standard control services and annual metering services in the subsequent regulatory control period in circumstances where the AER remakes its 2015 determination on or after 1 March 2018.</p>

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