RULE CHANGE

Australian Energy Market Commission

# CONSULTATION PAPER

## National Electricity Amendment (Aligning TasNetworks' regulatory control periods) Rule 2015

**Rule Proponent**

Tasmanian Networks Pty Ltd (TasNetworks)

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**About the AEMC**

The Council of Australian Governments, through its Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005. The AEMC has two principal functions. We make and amend the national electricity and gas rules, and we conduct independent reviews of the energy markets for the MCE.

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# 1 Introduction

On 22 October 2014, Tasmanian Networks Pty Ltd (TasNetworks) submitted a rule change request to the Australian Energy Market Commission (AEMC or Commission) in relation to aligning the regulatory control periods of its distribution and transmission networks.

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

This paper:

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

# 2 Details of the rule change request

## 2.1 Reasons for the rule change request and the proposed rule

TasNetworks submits that the current arrangements in the NER will result in a determination for its transmission or distribution network every two or three years.[1] It considers this places unnecessary costs on TasNetworks and the Australian Energy Regulator (AER) and reduces the scope for efficiency improvements.[2] TasNetworks suggests that this arrangement also undermines the planning and operational benefits of the merged network business.[3,4]

To rectify this problem, the rule change request proposes to align the regulatory control periods of TasNetworks' distribution and transmission networks. It proposes to achieve this by requiring the AER to set the length of the next regulatory control period for the distribution network to two years.[5] The regulatory control periods of TasNetworks' transmission and distribution networks would then be aligned from 1 July 2019. This is demonstrated in Figure 2.1 below.

**Figure 2.1 TasNetworks' proposal**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 | 2023-24 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Current reg cycle for TasNetworks (Distribution) | Current regulatory period | | | | | Next regulatory period | | | | | | |
| Current reg cycle for TasNetworks (Transmission) | | | Current - one-year | Next regulatory control period (process already commenced) | | | | Aligned regualtory period | | | | |
| TasNetworks' solution - Two year reg period for TasNetworks (Distribution) | Current regulatory period | | | | | 2 year period | | Aligned regulatory period | | | | |

Source: AEMC; TasNetworks' rule change request, 22 October 2014.

TasNetworks submits that it has consulted with its stakeholders on the rule change request.[6] It suggests its stakeholders were generally supportive of the rule change request and did not raise any issues with it.[7]

TasNetworks' rule change request includes a proposed rule.

1 TasNetworks' rule change request, 22 October 2014, p2.

2 ibid.

3 TasNetworks was created on 1 July 2014 through the merger of Aurora and Transend.

4 TasNetworks' rule change request, 22 October 2014, p2.

5 Currently the NER requires a regulatory control period to be at least five years. See NER clause 6.3.2(b).

6 TasNetworks' rule change request, 22 October 2014, pp3-4.

7 ibid.

## 2.2 Consideration as a non-controversial rule

The Commission proposes to treat this rule change request as a non-controversial rule.

Under s. 87 of the National Electricity Law (NEL), a "non-controversial Rule" is defined as:

> “a Rule that is unlikely to have a significant effect on the national electricity market”

Rule changes that are considered to be non-controversial may proceed under an expedited process, as provided under s. 96 of the NEL. Any person or body may object to the making of a rule under this expedited process within two weeks of the publication of the notice of initiation of the rule change process under s. 95 of the NEL.

The rule change request process will proceed on an expedited basis unless a valid objection is received. Additional information on due dates for submissions and objections is contained in Chapter 5.

# 3 Assessment framework

The Commission's assessment of this rule change request must consider whether the proposed rule promotes the national electricity objective (NEO) as set out under s. 7 of the NEL. The NEO states:

> "The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system."

Based on a preliminary assessment of this rule change request, the most relevant aspects of the NEO, for the purpose of this rule change request, are the efficient investment in and efficient operation of electricity services, in particular TasNetworks' transmission and distribution networks.

To determine whether the proposed rule, if made, is likely to promote the NEO, the following principles may be taken into account:

- **Minimise regulatory burden for TasNetworks and other stakeholders involved in the regulatory determination process.** A reduction in regulatory burden would reduce TasNetworks' administrative costs and thus enable TasNetworks to operate its business more efficiently. These cost savings should be passed onto consumers through lower network revenues and charges. Similarly, a reduction in regulatory burden for other stakeholders is likely to promote the efficient operation and use of electricity services.[8] Both the short term regulatory burden of having two TasNetworks distribution determination processes in quick succession, and the potential for an ongoing reduction in regulatory burden from the proposed rule should be considered.

- **Facilitate efficient planning of the network.** Aligning the regulatory control periods of TasNetworks' businesses has the potential to increase the ability of TasNetworks to plan for both networks at once thereby leading to more efficient planning of investment and operation of the two networks.

- **Provide for effective incentives.** The proposed two year regulatory control period for TasNetworks distribution business in 2017 would have weaker incentive properties than what a longer period would. This is because TasNetworks would not keep capital and operating expenditure efficiency savings, or bear greater than expected costs, for as long as it would should a

8 To the extent that these stakeholders are involved in the production and use of electricity services.

longer period apply. In this way, a shorter regulatory control period may initially lead to less efficient investments and operational decisions.

In assessing this rule change request it will be important to separate the impacts of aligning TasNetworks' regulatory control periods from the efficiency gains already achieved from the merger of Aurora and Transend to form TasNetworks.

# 4 Issues for consultation

We have identified some issues for consultation that are relevant to this rule change request. These issues, outlined below, are provided for guidance. Stakeholders are encouraged to comment on these issues as well as any other aspect of the rule change request or this paper, including the proposed assessment framework.

## 4.1 Potential issues with a two year regulatory control period

As set out in section 2.1, the rule change request proposes to require a two year regulatory control period for TasNetworks (distribution) commencing on 1 July 2017.

Due to the proposed short length of the 2017 regulatory control period and the length of the 2019 determination process,[9] the determination processes for TasNetworks' 2017 and 2019 distribution determinations will run consecutively with a small amount of overlap.

This means that TasNetworks, the AER and other relevant stakeholders will have limited knowledge of the outcomes of the 2017 determination process when making the 2019 determination. It may also impact AER and stakeholder resources and create confusion for stakeholders involved in the determination processes.

The overlap of the processes is set out in Figure 4.1. While not ideal, it does not appear to be a problem from a practical point of view. This is because the preliminary stages of the 2019 process that occur before the AER makes the 2017 final determination are not dependant on the 2017 final determination having been made.

**Figure 4.1 Overlap in determination processes**

| Steps in TasNetworks' 2017 and 2019 determination processes | Date |
|---|---|
| DNSP notifies AER on value of dual function assets | 31 Oct 2016 |
| DNSP notifies AER on need for changes to framework and approach | 31 Oct 2016 |
| AER consults on need for changes to components of framework and approach | 30 Nov 2016 |
| AER issues notice on need for framework and approach | 31 Dec 2016 |
| AER position paper on framework and approach | Not prescribed |
| AER 2017 final determination | 30 Apr 2017 |
| DNSP submits forecasting methodology | 30 June 2017 |
| AER framework and approach paper published | 31 July 2017 |

Source: AEMC; Chapter 6 of the NER.

9 A regulatory determination process can last 32 months. Where a decision is subject to merits review then the process is longer.

Another issue with a two year regulatory control period is that it generally has weaker incentive properties than a longer period. Network regulation in the national electricity market is based on incentive regulation, where network service providers are given an expenditure allowance for a period of time. To the extent a network service provider's actual expenditure is less than this allowance it keeps the difference for the remainder of the period. To the extent that it is higher, it bears the additional costs. The shorter the period, the weaker the incentive as a network service provider does not retain the benefits of any efficiency gains, or does not bear greater than expected costs, for as long. However, incentive schemes can be applied to mitigate this impact.[10]

It should be noted that the Commission has previously determined to apply a three year regulatory control period for SP AusNet as part of transitional arrangements.[11] In general, regulatory control periods are five years.

In practice, a final rule requiring a two year regulatory control period for the 2017 distribution determination would need to be in place in time for TasNetworks to take this into account in preparing its distribution regulatory proposal.[12]

| Question 1 | Are the disadvantages of a two year regulatory control period to achieve alignment material enough to outweigh the benefits from alignment? |
| --- | --- |

## 4.2 Stakeholder resources

As noted in section 2.1, TasNetworks proposes to align the regulatory control periods of its distribution and transmission networks from 1 July 2019. There are a number of other service providers that have a regulatory control period on 1 July 2019. This means the AER will need to make determinations for these service providers at this time. These are the NSW distribution network service providers, ActewAGL, Directlink and Jemena Gas Networks.

There is a question as to whether the AER has the resources to make a distribution determination for TasNetworks at the same time as making determinations for these other service providers. The availability of expert consultants during the determination processes for these service providers could also be an issue for the AER and other stakeholders involved in the process such as consumers and their representatives.

10 See for example, AER, Efficiency benefit sharing scheme for electricity network service providers, November 2013; AER, Capital expenditure incentive guideline for electricity network service providers, November 2013.

11 AEMC, *Economic regulation of network service providers and Price and revenue regulation of gas services*, 29 November 2012, p234.

12 TasNetworks is required to submit its distribution regulatory proposal by 31 January 2016.

There is also likely to be an increased workload for TasNetworks, the AER and other stakeholders during the overlap in the 2017 and 2019 distribution determination processes as discussed in section 4.1.

TasNetworks submits that it has consulted with relevant stakeholders including large and small customers about the rule change request. TasNetworks also submits that it has also spoken to the AER about the rule change request and suggests that the AER is comfortable with having TasNetworks distribution on the same regulatory cycle as the transmission network.[13]

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|---|---|
| **Question 2** | **To what extent are stakeholder resourcing issues a problem with the proposed rule?** |

## 4.3 Legal drafting of the proposed rule

The proposed rule included as part of TasNetworks' rule change request is drafted as a participant derogation from clause 6.3.2(b) of the NER.[14] However, clause 6.3.2 does not provide a right or obligation on TasNetworks from which a derogation could be possible. The proposed rule would therefore not appear to be appropriately drafted as a participant derogation.

For the purpose of consultation, some alternative suggested drafting designed to implement the policy objective in the rule change request and proposed rule is provided. This drafting has been included in as an attachment to this paper in the form of an alternative indicative rule.

The alternative drafting does not predetermine that a rule would be made. Rather, the intention is to ensure stakeholders are given the opportunity to comment on the alternative drafting. For a non controversial rule, there is no subsequent opportunity for stakeholders to formally comment on a rule as the next step in the expedited rule making process is the final determination.[15]

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| **Question 3** | **Please provide any comments you have on the alternative drafting of the proposed rule?** |

13 TasNetworks' rule change request, 22 October 2014, pp3-4.

14 NER clause 6.3.2 requires a regulatory control period to be at least five years.

15 Providing there are no objections to the proposed rule being expedited.

## 4.4 Alternative solutions to the problem

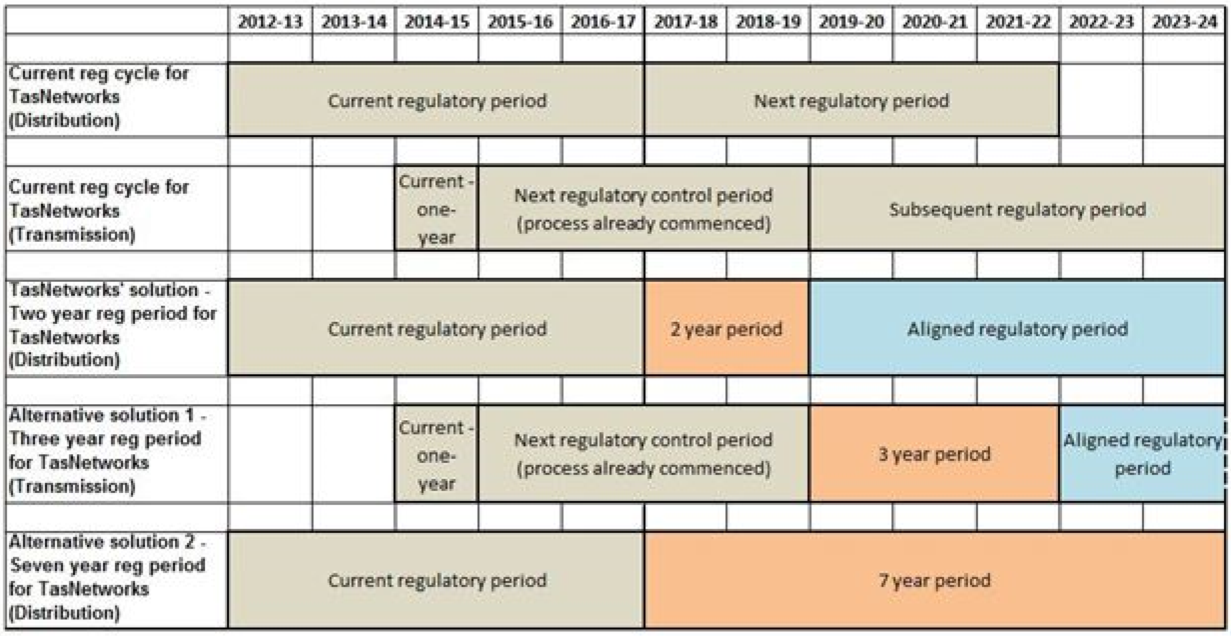
There are two other ways in which the regulatory control periods of the two network businesses could be aligned:

- The first (alternative solution one) would require the AER to set a three year regulatory control period for the transmission network in 2019-20. Under this solution the regulatory control period of the transmission network aligns with that of the distribution network from 1 July 2022.

- The second (alternative solution 2) would require the AER to set a seven year period for the 2017 distribution determination. Under this solution the regulatory control periods of the two networks would be aligned from 1 July 2024. A rule change would not be required for this solution.[16]

The two alternative solutions in addition to the TasNetworks' solution are illustrated in Figure 4.2.

### Figure 4.2 Different alignment options




Source: AEMC.

There are potentially advantages and disadvantages with each of the three different options for alignment.

The key advantage with TasNetworks' proposed rule is that it achieves alignment the soonest. However, as discussed in section 4.1 there are some potential issues with a two year regulatory control period under this option.

16 This is because the AER can determine that a regulatory control period must be seven years.

The issues of a two year regulatory control period are slightly reduced under the first alternative. This option would also more closely align the regulatory control period of TasNetworks' transmission network with those of other transmission network service providers in the national electricity market.[17] This may assist the AER in undertaking benchmarking of these service providers.

The key disadvantage with this option is that it would require one more regulatory determination to be undertaken before alignment would occur compared to the TasNetworks solution. This would delay the benefits of alignment.

Under alternative solution two, there is a greater risk that assumptions made in a determination, such as forecasts of demand, will be different from what was forecast in the determination. As with alternative option one, one more regulatory determination would need to be undertaken before alignment occurs compared to the TasNetworks solution under this option.

| | |
|---|---|
| **Question 4** | **Do either of the two alternative solutions better meet the NEO than the solution proposed by TasNetworks, and why?** |

17 For example, AusNet Services and Powerlink are scheduled to commence regulatory control periods in 2022.

# 5 Lodging a submission

Submissions on the rule change request are to be lodged by 26 March 2015. Any objections to the making of a rule under the expedited process are to be lodged by 12 March 2015.

Submissions and any objections to the making of a rule under the expedited process are to be lodged online via the Commission's website, www.aemc.gov.au or by mail to:

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Or by Fax to (02) 8296 7899.

Where practicable, submissions should be prepared in accordance with the Commission's guidelines for making written submissions on rule change requests.[18] The Commission publishes all submissions on its website, subject to a claim of confidentiality.

All enquiries on this project should be addressed to Neil Howes on (02) 8296 7800.

18 This guideline is available on the Commission's website.

## Abbreviations

| | |
|---|---|
| AEMC | Australian Energy Market Commission |
| AER | Australian Energy Regulator |
| Commission | See AEMC |
| NEL | National Electricity Law |
| NEO | national electricity objective |