



CitiPower Pty
ACN 064 651 056
www.citipower.com.au

Head Office: 40 Market Street Melbourne Victoria
Telephone: (03) 9683 4444 Facsimile: (03) 9683 4499 DX 433 Melbourne
Postal address: Locked Bag 14090 Melbourne Victoria 8001 Australia

Powercor Australia Ltd
ACN 064 651 109
www.powercor.com.au

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Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Lodged online at www.aemc.gov.au

Dear Dr Tamblyn

National Electricity Amendment (Payment under Feed-in Schemes and Climate Change Funds) Rule 2010 (Project Ref. ECR0097)

Thank you for providing CitiPower and Powercor with the opportunity to comment on the Draft National Electricity Amendment (Payment under Feed-in Schemes and Climate Change Funds) Rule 2010 (**Draft Rule**).

CitiPower and Powercor support the making of a rule change to provide for a more effective and efficient mechanism for Distribution Network Service Providers to recover payments made in relation to feed-in tariff schemes, climate change funds and other relevant legislation.

CitiPower and Powercor are also broadly supportive of the Draft Rule. However, CitiPower and Powercor consider that the Draft Rule should be amended to:

- include a more effective under/over recovery mechanism;
- ensure that it covers feed-in tariff schemes and other relevant schemes that may in the future be enacted by the Commonwealth; and
- correct other minor miscellaneous issues

Under/over payment mechanism

Concerns with the under/over recovery mechanism in the Draft Rule

CitiPower and Powercor consider that the proposed over/under recovery mechanism in the Draft Rule does not provide for a complete and effective true-up of amounts that were under or over recovered in previous years.

Draft rule 6.18.7A requires a DNSP's pricing proposal to provide for tariffs designed to pass on to customers the payments that a DNSP is required to make in relation to feed-in tariff schemes and other approved jurisdictional schemes. The amount that can be passed on in any regulatory year must not exceed the estimated amount of jurisdictional scheme amounts for the forthcoming regulatory year plus an adjustment for under or over-recovery in the previous year.

CitiPower and Powercor consider that there are two problems with the under and over recovery mechanism in draft rule 6.18.7A.

1. The Draft Rule is not consistent with the timing for submission of pricing proposals

Under rule 6.18.2, a pricing proposal must be submitted approximately two months before the commencement of each regulatory year. Draft rule 6.18.7A only allows the under and over recovery to be determined based on the *relevant preceding year*¹. The *relevant preceding year* is the year preceding the year in which the pricing proposal is to apply, and is therefore the year in which the pricing proposal is prepared and submitted.

Accordingly, at the time of submitting the pricing proposal, it will not be possible to accurately determine the amount of any under or over recovery for the *relevant preceding year*, as that year will be incomplete. A DNSP could only determine the actual under and over recovery for the first eight or nine months of that regulatory year, and it would have to estimate the likely under and over recovery for the remaining two months or more after the pricing proposal is prepared.

The Draft Rule addresses this issue in the transitional Chapter 6 of the Rules that applies to NSW and the ACT. Schedule 2 of the Draft Rule modifies the meaning of '*relevant preceding year*' and essentially extends the meaning of that term to cover any previous *regulatory year*. However, that amendment only applies in NSW and ACT and will not solve this problem for Victorian DNSPs.

The under/over recovery mechanism in the draft rule will therefore not provide for an accurate true-up of previous payments for Victorian DNSPs.

2. The Draft Rule does not account for the time value of money

The Draft Rule does not account for the time value of money and the cost that is incurred by DNSPs as a result of the delay in receiving any under recovery (or the benefit that is gained by DNSPs as a result of the delay in paying any over recovery).

The amount of the under or over recovery should be adjusted to account for inflation and the DNSP's nominal WACC.

Proposed amendments to the Draft Rule

The two issues identified above can be addressed by amending paragraphs (b) and (c) of draft rule 6.18.7A and making minor consequential changes to other aspects of the Draft Rule (together, **Proposed Amendments**), as set out in the Attachment to this submission.

Consistency of the Draft Rule with existing jurisdictional arrangements

Both of the issues raised above in respect of the under and over recovery mechanism in draft rule 6.18.7A are currently addressed by the analogous 'correction factor' for transmission tariffs that is set out in sections 3.3.3 to 3.3.5 of the Essential Services Commission's 2006-2010 Victorian Electricity Distribution Price Review Determination (**2006-2010 EDPR**). That correction factor requires a DNSP to adjust its proposed transmission tariffs to allow for under or over recovery of amounts paid or earned in relation to transmission use of system charges, transmission connection charges, inter-network provider distribution service charges, and payments to embedded generators.

The correction factor formula in the 2006-2010 EDPR provides for a comprehensive true-up mechanism that addresses any under or over recovery. As in the Draft Rule, the correction

¹ With the exception of sub-headings and Act titles, italics are used in this letter to denote terms that are defined in Chapter 10 of existing Rules, as amended by the Draft Rule, and italicised terms where appearing in this letter are intended to take that defined meaning.

factor accounts for the difference between the DNSP's estimated revenue and payments for transmission charges in the current incomplete year in which the pricing proposal is prepared (year t-1). However, the correction factor then goes on to also true-up those estimates against the actual amounts of revenue and payments. It does so by accounting for the difference between the DNSP's actual audited values for the previous year (year t-2) and the estimates for year t-2 that the DNSP used when calculating the correction factor in its transmission pricing for year t-1.

This approach ensures that prices are ultimately based on actual revenue and payments figures rather than estimates and there is no under or over recovery that is not taken into account in pricing.

The correction factor formula also allows for the time value of money by multiplying the under or over recovery amount by $1+CPI$ and $1+pretaxWACC$.

CitiPower and Powercor have adopted a similar approach to the 2006-2010 EDPR in the Proposed Amendments set out in the Attachment.

Proposed Amendments promote the NEO and the relevant revenue and pricing principles

The Proposed Amendments will better contribute to the achievement of the national electricity objective than the AEMC's Draft Rule. Having regard to the efficiency benefits of the Draft Rule that the AEMC refers to on pages 5 and 6 of the Draft Rule Determination, CitiPower and Powercor consider that the Proposed Amendments will deliver the following benefits:

- **Administrative efficiency:** The Proposed Amendments will provide a clearer method for calculating the under/over recovery amount. The true-up mechanism in the AEMC's draft rule cannot be implemented in practice, because it requires DNSPs to determine the actual amounts paid and passed on to customers under jurisdictional schemes at a time when that information is not available to DNSPs. Imposing an obligation that cannot be implemented in practice will lead to inefficiency and uncertainty for DNSPs, the AER and distribution customers.
- **Efficiency and accuracy of payment forecasts:** The proposed amendments will provide a more accurate calculation of the amounts paid by DNSPs and passed on to customers and will ensure that there is a full true-up between DNSPs' forecasts and actual amounts. The amendments will ensure that DNSPs only pass through to customers the amount of the actual costs incurred by the DNSPs. In comparison, the Draft Rule will result in some under or over recovery from customers that is never remedied and will therefore result in windfall gains and losses for DNSPs and customers.

The revenue and pricing principles are also relevant to the rule making test under section 88B of the National Electricity Law (**NEL**). The revenue and pricing principle in section 7A(2) of the NEL is relevant. That principle provides that a DNSP should be provided with a reasonable opportunity to recover at least the efficient costs that it incurs in complying with a regulatory obligation.

As the AEMC notes on page 7 of the Draft Rule Determination, prices should allow for a return commensurate with the regulatory and commercial risks in providing the service. The Proposed Amendments will better give effect to this principle by ensuring that any under or over recovery of payments is adjusted to account for the time value of money. Under the Draft Rule, a DNSP would recover less than an efficient return in the circumstances where there is an adjustment due to under recovery, and a DNSP would recover more than an efficient return where there is an adjustment due to over recovery. CitiPower and Powercor's Proposed Amendments ensure that a DNSP will always recover only an efficient return under any form of adjustment.

Commonwealth schemes

The Draft Rule only applies to obligations imposed under an Act of a *participating jurisdiction* or an order or instrument made under an Act of a *participating jurisdiction* (see in particular the draft definition of *jurisdictional scheme obligations*). It is unclear whether the Commonwealth is a *participating jurisdiction* for these purposes.

The Draft Rule should apply to Acts of the Commonwealth. There is a real likelihood that the Commonwealth will introduce legislation of a kind that should be covered by the Draft Rule and that would impose an obligation to pay amounts that meet the other tests in the proposed definition of *jurisdictional scheme amounts*. For example, the Commonwealth has introduced the *Renewable Energy Amendment (Feed-in Tariff for Electricity) Bill 2009*.

CitiPower and Powercor propose that the Draft Rule should be amended to ensure that it can also apply to Acts of the Commonwealth. The required amendments are set out in the Attachment to this submission (**Further Proposed Amendments**).

These Further Proposed Amendments will better contribute to the achievement of the national electricity objective than the AEMC's Draft Rule. They will promote efficiency by providing for a more efficient mechanism to pass through costs that are incurred in relation to Commonwealth schemes. They will also better give effect to the revenue and pricing principles by ensuring that DNSPs can recover costs that they incur under Commonwealth schemes and are therefore provided with a reasonable opportunity to recover at least the efficient costs that they incur in complying with a regulatory obligation.

Miscellaneous issues

Under clause 6.18.7A(x) of the Draft Rule, one of the requirements of the *jurisdictional scheme eligibility criteria* is that the amount is not in the nature of a fine, penalty or incentive payment. It should be clarified that the amount must not be an incentive for the DNSP. The jurisdictional schemes will generally be intended to provide incentives for the person that receives the payment, eg the customer.

There appears to be a typographical error in the transitional provision in clause 11.[.].2(b) of the Draft Rule. The reference to 'the new clause 6.18.6(d)' should instead refer to 'the new clause 6.18.6(d)(3)'.

If you wish to discuss the matters raised by CitiPower and Powercor in this submission, please do not hesitate to contact me on (03) 9683 4282.

Yours sincerely



Rolf Hermann
MANAGER REGULATION

Attachment

Proposed amendments to draft rules

Clause 6.18.2 Pricing proposals

(6A) set out how *jurisdictional scheme amounts* for each *approved jurisdictional scheme* are to be passed on to customers and any adjustments to tariffs resulting from over or under recovery of those amounts in the *relevant preceding years*; and

6.18.7A Recovery of jurisdictional scheme amounts

Pricing proposal

- (a) A *pricing proposal* must provide for tariffs designed to pass on to customers a *Distribution Network Service Provider's jurisdictional scheme amounts* for *approved jurisdictional schemes*.
- (b) The amount to be passed on to customers for a particular *regulatory year (year t)* must not exceed the estimated amount of *jurisdictional scheme amounts* for a *Distribution Network Service Provider's approved jurisdictional schemes* for the relevant *regulatory year* adjusted for over or under recovery in the *relevant preceding years*.
- (c) The extent of the over or under recovery is the sum of the amounts in paragraphs (1) to (3), adjusted to account for inflation and the nominal WACC set out in the *Distribution Network Service Provider's* distribution determination~~the difference between:~~
- (1) the difference between:
- (i) the *Distribution Network Service Provider's* estimate~~the actual amount~~ of the *Distribution Network Service Provider's jurisdictional scheme amounts* in the *regulatory year* prior to *year t*~~relevant preceding year (year t-1)~~; and
- (ii) the *Distribution Network Service Provider's* estimate of the amount passed on to customers in respect of *jurisdictional scheme amounts* by the *Distribution Network Service Provider* in *year t-1*~~the relevant preceding year~~; and
- (2) the difference between:
- (i) the actual amount of the *Distribution Network Service Provider's* jurisdictional scheme amounts in the *regulatory year* two years prior to *year t* (*year t-2*); and
- (ii) the estimate of the *Distribution Network Service Provider's* jurisdictional scheme amounts in *year t-2* that was used for the purposes of paragraph (c)(1)(i) when preparing the *Distribution Network Service Provider's pricing proposal* for *year t-1*; and

(3) the difference between:

- (i) the actual amount passed on to customers in respect of *jurisdictional scheme amounts* by the *Distribution Network Service Provider* in year t-2;
and
- (ii) the estimate of the amount passed on to customers in respect of *jurisdictional scheme amounts* by the *Distribution Network Service Provider* in year t-2 that was used for the purposes of paragraph (c)(1)(ii) when preparing the *Distribution Network Service Provider's pricing proposal* for year t-1.

...

(y) To avoid doubt, in this clause 6.18.7A and the definition in Chapter 10 of *jurisdictional scheme obligations*, any reference a *participating jurisdiction* includes the Commonwealth.

Clause 10 New definitions

relevant preceding years

- (a) The two previous *regulatory years*; ~~or~~
- (b) In respect of the *pricing proposal* for the first year of a *regulatory control period*, the last two *regulatory years* of the previous *regulatory control period*; or
- (c) In respect of the *pricing proposal* for the second year of a *regulatory control period*, the previous *regulatory year* and the last *regulatory year* of the previous *regulatory control period*.