



**Statement on control mechanisms
for alternative control services for the ACT and
NSW 2009 distribution determinations**

February 2008

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Shortened forms

ACCC	Australian Competition and Consumer Commission
AER	Australian Energy Regulator
CPI	consumer price index
DNSP	distribution network service provider
ICRC	Independent Competition and Regulatory Commission (ACT)
IPART	Independent Pricing and Regulatory Tribunal (NSW)
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEM	National electricity market
NER	National Electricity Rules
Public lighting code	NSW Public Lighting Code
RAB	regulatory asset base
WACC	weighted average cost of capital

1 Nature and authority

1.1 Introduction

This statement sets out the Australian Energy Regulator's (AER) likely approach to determining the form of control for alternative control services, to apply to the 2009–14 ACT and NSW electricity distribution determinations.

The AER is responsible for regulating the revenues and/or prices of distribution network service providers (DNSPs) in the national electricity market (NEM) in accordance with the National Electricity Rules (NER), which were notified in the South Australian Gazette on 20 December 2007.

Within the NER, Chapter 6 deals with the classification and economic regulation of distribution services, while Chapter 6A deals with the economic regulation of transmission services. The Ministerial Council on Energy (MCE) has determined that transitional arrangements will apply to the preparation and assessment of the ACT and NSW 2009 distribution determinations. The transitional arrangements for the 2009–14 regulatory control periods for the ACT and NSW are set out in appendix 1 to Chapter 11 of the NER. Clause references in appendix 1 are numbered commencing with a six. This statement will only apply to the transitional regulatory control period, 2009–14.

The NER distinguishes between the rules in Chapter 6 and Chapter 11 by referring to the Chapter 6 rules as 'general Chapter 6 rules,' and Chapter 11 rules as 'transitional Chapter 6 rules.' The AER has followed this convention in this document when referring to the two sets of rules.

1.2 Authority

The AER must publish a statement indicating its likely approach to the control mechanism for alternative control services under Clause 6.2.5(e) of the transitional Chapter 6 rules. This document represents the AER's statement on the control mechanism that is likely to apply to alternative control services.

This decision and corresponding statement apply to Country Energy, EnergyAustralia and Integral Energy (collectively referred to in these documents as 'the NSW DNSPs') and ActewAGL.

1.3 Confidentiality

The AER's obligations regarding confidentiality and the disclosure of information provided to it by a DNSP are governed by the *Trade Practices Act 1974*, the National Electricity Law (NEL) and the NER.

1.4 Selection of the control mechanism for alternative control services

The transitional Chapter 6 rules, at clauses 6.2.3B and 6.2.3C, prescribe which services will be classified as alternative control services:

- ACT: the provision of and servicing of meters for customers consuming fewer than 160 megawatt hours per annum (types 5–7 meters), including:
 - meter testing
 - meter reading
 - meter checking
 - the processing of metering data
 - the provision of non-standard meters
- NSW: the construction and maintenance of public lighting infrastructure by DNSPs in NSW.

The transitional Chapter 6 rules also provide that in the future additional services may be classified as alternative control services. Clause 6.2.3B(b)(2)(ii) provides that the services, set out below, which are to be classified as unregulated in 2009–14, may be classified as alternative control if the AER determines that the DNSP is no longer in substantial compliance with the provisions of the Independent Pricing and Regulatory Tribunal’s (IPART’s) Rule 2004/1— Regulation of Excluded Distribution Services:

- customer funded connections
- customer specific services
- type one to four metering services.

Clause 6.2.3C(c) of the transitional Chapter 6 rules does allow the AER to vary the deemed classification of services in the ACT for the distribution determination provided it has the consent of ActewAGL.

The transitional Chapter 6 rules, at 6.2.5(c2), require the control mechanisms to be chosen from the list set out below.

6.2.5 Control mechanisms for direct control services

- (c2) The control mechanism for *alternative control services* may consist of:
- (1) a schedule of fixed prices;
 - (2) caps on the prices of individual services;
 - (3) caps on the revenue to be derived from a particular combination of services;
 - (4) tariff basket price control;
 - (5) revenue yield control;
 - (6) a combination of any of the above.

In considering the appropriate control mechanisms for alternative control services for the regulatory control period 2009–14, the AER is required to have regard to the following, which are set out at clause 6.2.5(d) of the transitional Chapter 6 rules:

- (1) the potential for development of competition in the relevant market and how the control mechanism might influence that potential; and
- (2) the possible effects of the control mechanism on administrative costs of the AER, the *Distribution Network Service Provider* and users or potential users; and
- (3) the regulatory arrangements (if any) applicable to the relevant service immediately before the commencement of the distribution determination; and
- (4) the desirability of consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction); and
- (5) any other relevant factor.

2 Control mechanism for alternative control services

2.1 Difference between ACT and NSW

There are significant differences between:

- the services prescribed in the transitional Chapter 6 rules as alternative control services for the ACT and services for NSW
- the approaches adopted previously by the Independent Competition and Regulatory Commission (ICRC) and IPART with regard to regulation of excluded services.

Accordingly, the AER considers it appropriate to apply separate control mechanisms to the alternative control services of ActewAGL and the NSW DNSPs.

2.2 Form of the control mechanism

The purpose of an alternative control mechanism is to give the AER the discretion to apply a different form of regulation to that applied to standard control services. In determining an appropriate form of regulation the AER has considered the issues that it is required to have regard to, set out at Clause 6.2.5(d) of the transitional Chapter 6 rules.

2.2.1 ACT

For metering services in the ACT, the AER will maintain the total revenue control mechanism adopted by the ICRC during the current regulatory control period.

Under this approach, ActewAGL will propose a revenue allowance based on a building block analysis, with maximum allowable revenues to be escalated each year by the consumer price index (CPI). The revenue allowance will be established based on the rolled-forward value of the relevant metering assets, and an analysis of costs associated with providing the services.

ActewAGL's building block proposal for these services will need to include some detail on each building block cost element. In assessing these costs the AER will have regard to whether the proposed costs are efficient. The AER proposes to allow a return on capital for alternative control services, equal to that allowed for standard control services.

2.2.2 NSW

For public lighting services in NSW, the transitional Chapter 6 rules require the AER to set out an explicit control mechanism (or mechanisms) to apply to public lighting services during the next regulatory control period. The AER proposes to apply the following forms of control to public lighting services over the next regulatory control period:

- a schedule of fixed prices in the first year of the regulatory control period

- a price path (such as CPI-X) for the remaining years of the regulatory control period.

The AER proposes to determine the initial price levels and the price path with reference to the efficient costs of providing public lighting services. A limited building block analysis will be employed to assess the efficiency of the prices. Key features of the limited building block approach include:

- DNSPs will not be required to provide a separate proposal on the weighted average cost of capital (WACC) for public lighting services. The AER proposes to apply the same WACC as applied to standard control services.
- DNSPs may propose reasonable simplifying assumptions within the building block model. In particular, the AER will accept the present depreciation assumptions applied by DNSPs.
- DNSPs may base their opening asset valuation on the value derived from the previous IPART determination, with any efficient adjustments for capex and depreciation in the current regulatory control period. The AER proposes that the asset valuation for public lighting should be derived by deducting the opening regulatory asset base (RAB) from the 2004–09 regulatory control period (which only included prescribed services) from the closing RAB from the 1999–2004 regulatory control period (which included both prescribed and public lighting services).

Efficient costs need to be assessed against a specific level of service. For the next regulatory control period, the AER proposes to make this assessment against the NSW Public Lighting Code (Public Lighting Code). The Public Lighting Code is a voluntary code that was introduced to help clarify the relationship between public lighting service providers and customers and sets out some benchmarks to assist local councils. In particular, it sets out:

- minimum maintenance standards and associated service level guarantees
- minimum requirements for inventories, management plans, performance reporting and billing
- a requirement that service providers consult with customers in deciding which core lighting types they are going to offer
- a mechanism allowing for connection of lighting types outside the core choices offered by service providers.

Regulatory proposal for public lighting in NSW

The transitional Chapter 6 rules outline the information which must be provided as part of the DNSP's regulatory proposal for alternative control services. This includes:

- the proposed control mechanism, a demonstration of the application of the proposed control mechanism, and the necessary supporting information
- in the case of a departure from the AER's likely approach to the relevant control mechanisms for alternative control services, a statement of the reasons justifying the departure
- indicative prices for each year of the regulatory control period

- identification of any negotiable components and the proposed negotiating framework.

The following information should be provided to support the proposed control mechanism:

- an overview of the public lighting services provided by the DNSP
- cost information, including:
 - the historic capex and opex costs, including replacement costs
 - the proposed capex and opex costs over the next regulatory control period, including replacement costs
 - a justification for any material differences between historic and proposed 2009–14 costs
- asset value information, including:
 - the opening asset value as at 1 July 2004 and any calculations or documents to demonstrate its derivation
 - the proposed opening asset valuation at 30 June 2009 including adjustments to account for past capex and depreciation
- pricing information, including:
 - a schedule of prices for the first year
 - a proposed price path
 - indicative prices for each year of the regulatory control period
- service level information, including:
 - a demonstration of how the proposed costs reflect the levels of service outlined in the Public Lighting Code
 - procedures for mediating disputes and remedies where service levels have not been met.

Where the service level outlined in the Public Lighting Code is not acceptable or appropriate, customers may negotiate with the DNSP for a variation in prices which is reflective of the agreed service levels.

Annual pricing proposal for public lighting in NSW

Under the transitional Chapter 6 rules, DNSPs will be required to submit an annual pricing proposal for public lighting services. DNSPs will be required to follow the pricing principles outlined in the transitional Chapter 6 rules.

2.3 DNSP's to provide demonstration

Clause 6.8.2(3A) of the transitional Chapter 6 rules states that in their regulatory proposals, the DNSPs are required to provide a demonstration of the application of the proposed control mechanism and the necessary supporting information. If a DNSP departs from the control mechanism indicated by the AER's statement the DNSP is to provide reasons justifying the departure.

2.4 Amendments

This statement constitutes the AER's likely approach to the control mechanism for alternative control services. The AER may make amendments to its approach at the distribution determination. If the AER does make any amendments to the control mechanism for alternative control services it will provide its reasons for doing so.