



Rule change proposal

**Price and revenue regulation of gas distribution  
and transmission services**

**AER's proposed changes to the rate of return  
provisions of the National Gas Rules**

**Complete Part 9 Draft Rules**

September 2011

## Proposed rule change: cost of capital

No.	Current rule(s)	Proposed rule(s)	Remarks
[9.1]	87(1) 87(2)(a)(i) 87(2)(a)(ii) 87(2)(b)	87(1)(a) 87(1)(b)	Revisions to: <ul style="list-style-type: none"> <li>– prescribe the form of the WACC, including the capm; and</li> <li>– require the cost of capital to be determined in accordance with the statement on the cost of capital.</li> </ul>
[9.1.1]	69 72(1)(g)	69 72(1)(g)	Consequential revisions.
[9.2]	–	87A(1) 87A(2) 87A(3) 87A(4)(a) 87A(4)(b) 87A(4)(c) 87A(4)(d) 87A(4)(e) 87A(4)(f) 87A(5)(a) 87A(5)(b) 87A(5)(c) 87A(5)(d) 87A(5)(e) 87A(6) 87A(7) 87A(8)(a)(i) 87A(8)(a)(ii) 87A(8)(a)(iii) 87A(8)(b) 87A(8)(c) 87A(8)(d)(i) 87A(8)(d)(ii) 87A(8)(e)(i) 87A(8)(e)(ii)	New rule 87A to <ul style="list-style-type: none"> <li>– provide for the AER to undertake a review of the rate of return and publish a statement on the cost of capital; and</li> <li>– provide a timeframe for undertaking the review consistent with the timeframe specified in proposed clauses 6.5.2(a) and 6A.6.2(a) of the NER.</li> </ul>
[9.3]	–	(Division 5B) 87B(1)(a) 87B(1)(b) 87B(2)(a) 87B(2)(b)	New rule 87B to provide for the estimated cost of corporate income tax to be a building block and to be calculated for a service provider.
[9.3.1]	72(h) 76(c)	72(h) 76(c)	Consequential revisions.

## Part 9 Price and revenue regulation

### Division 1 Preliminary

#### 69 Interpretation

In this Part:

**capital base**, in relation to a pipeline, means the capital value to be attributed, in accordance with this Part, to pipeline assets.

**capital expenditure** means costs and expenditure of a capital nature incurred to provide, or in providing, pipeline services.

**conforming capital expenditure** means capital expenditure that complies with the new capital expenditure criteria.

**depreciation** means depreciation of the capital base.

**new capital expenditure criteria** mean the criteria stated in rule 79.

**non-conforming capital expenditure** means capital expenditure that does not comply with the new capital expenditure criteria.

**operating expenditure** means operating, maintenance and other costs and expenditure of a non-capital nature incurred in providing pipeline services and includes expenditure incurred in increasing long-term demand for pipeline services and otherwise developing the market for pipeline services.

**pipeline assets**, in relation to a pipeline, means capital assets that constitute the pipeline or are otherwise used by the service provider to provide services.

[statement on the cost of capital means the statement published by the AER under rule 87A\(3\).](#)

[9.1.1]

**tariff class** means customers for one or more reference services who constitute a tariff class under a full access arrangement.

#### 70 Application of this Part

This Part applies only in respect of a full access arrangement (or a *full access arrangement proposal*).

#### 71 Assessment of compliance

- (1) In determining whether capital or operating expenditure is efficient and complies with other criteria prescribed by these rules, the AER may, without embarking on a detailed investigation, infer compliance from the operation of an incentive mechanism or on any other basis the AER considers appropriate.

- (2) The AER must, however, consider, and give appropriate weight to, submissions and comments received when the question whether a relevant *access arrangement proposal* should be approved is submitted for public consultation.

## **Division 2            Access arrangement information relevant to price and revenue regulation**

### **72            Specific requirements for access arrangement information relevant to price and revenue regulation**

- (1) The *access arrangement information* for a *full access arrangement proposal* (other than an *access arrangement variation proposal*) must include the following:
- (a) if the *access arrangement period* commences at the end of an earlier *access arrangement period*:
    - (i) capital expenditure (by asset class) over the earlier *access arrangement period*; and
    - (ii) operating expenditure (by category) over the earlier *access arrangement period*; and
    - (iii) usage of the pipeline over the earlier *access arrangement period* showing:
      - (A) for a distribution pipeline, minimum, maximum and average demand and, for a transmission pipeline, minimum, maximum and average demand for each *receipt or delivery point*; and
      - (B) for a distribution pipeline, customer numbers in total and by tariff class and, for a transmission pipeline, user numbers for each *receipt or delivery point*;
  - (b) how the capital base is arrived at and, if the *access arrangement period* commences at the end of an earlier *access arrangement period*, a demonstration of how the capital base increased or diminished over the previous *access arrangement period*;
  - (c) the projected capital base over the *access arrangement period*, including:
    - (i) a forecast of conforming capital expenditure for the period and the basis for the forecast; and
    - (ii) a forecast of depreciation for the period including a demonstration of how the forecast is derived on the basis of the proposed depreciation method;
  - (d) to the extent it is practicable to forecast pipeline capacity and utilisation of pipeline capacity over the *access arrangement period*, a forecast of pipeline

capacity and utilisation of pipeline capacity over that period and the basis on which the forecast has been derived;

- (e) a forecast of operating expenditure over the *access arrangement period* and the basis on which the forecast has been derived;
  - (f) the key performance indicators to be used by the service provider to support expenditure to be incurred over the *access arrangement period*;
  - (g) the proposed rate of return, ~~the assumptions on which the rate of return is calculated and a demonstration of how it is calculated~~ calculated in accordance with rule 87; [9.1.1]
  - (h) ~~the proposed method for dealing with taxation, and a demonstration of how the allowance for taxation is calculated~~ the estimated cost of corporate income tax calculated in accordance with rule 87A; [9.3.1]
  - (i) if an incentive mechanism operated for the previous *access arrangement period*—the proposed carry-over of increments for efficiency gains or decrements for efficiency losses in the previous *access arrangement period* and a demonstration of how allowance is to be made for any such increments or decrements;
  - (j) the proposed approach to the setting of tariffs including:
    - (i) the suggested basis of reference tariffs, including the method used to allocate costs and a demonstration of the relationship between costs and tariffs; and
    - (ii) a description of any pricing principles employed but not otherwise disclosed under this rule;
  - (k) the service provider's rationale for any proposed *reference tariff variation mechanism*;
  - (l) the service provider's rationale for any proposed incentive mechanism;
  - (m) the total revenue to be derived from pipeline services for each regulatory year of the *access arrangement period*.
- (2) The *access arrangement information* for an *access arrangement variation proposal* related to a full access arrangement must include so much of the above information as is relevant to the proposal.

## 73 Basis on which financial information is to be provided

- (1) Financial information must be provided on:
  - (a) a nominal basis; or
  - (b) a real basis; or

- (c) some other recognised basis for dealing with the effects of inflation.
- (2) The basis on which financial information is provided must be stated in the *access arrangement information*.
- (3) All financial information must be provided, and all calculations made, consistently on the same basis.

## 74 Forecasts and estimates

- (1) Information in the nature of a forecast or estimate must be supported by a statement of the basis of the forecast or estimate.
- (2) A forecast or estimate:
  - (a) must be arrived at on a reasonable basis; and
  - (b) must represent the best forecast or estimate possible in the circumstances.

## 75 Inferred or derivative information

Information in the nature of an extrapolation or inference must be supported by the primary information on which the extrapolation or inference is based.

## Division 3 Building block approach

### 76 Total revenue

Total revenue is to be determined for each regulatory year of the *access arrangement period* using the building block approach in which the building blocks are:

- (a) a return on the projected capital base for the year (See Divisions 4 and 5); and
- (b) depreciation on the projected capital base for the year (See Division 6); and
- (c) ~~if applicable~~—the estimated cost of corporate income tax for the year ([See Division 5A](#)); and
- (d) increments or decrements for the year resulting from the operation of an incentive mechanism to encourage gains in efficiency (See Division 9); and
- (e) a forecast of operating expenditure for the year (See Division 7).

[9.3.1]

## Division 4      The Capital base

### 77      Opening capital base

- (1) When a pipeline first becomes a covered pipeline, or the opening capital base for a pipeline is first calculated, the opening capital base is to be as follows:
- (a) if the pipeline was commissioned before the commencement of these rules, the opening capital base is to be determined by reference to the relevant provisions of the Gas Code;
  - (b) if the pipeline was commissioned after the commencement of these rules, the opening capital base is to be:
    - (i) the cost of construction of the pipeline and pipeline assets incurred before commissioning of the pipeline (including the cost of acquiring easements and other interests in land necessary for the establishment and operation of the pipeline);plus:
    - (ii) the amount of capital expenditure since the commissioning of the pipeline;less:
    - (iii) depreciation; and
    - (iv) the value of pipeline assets disposed of since the commissioning of the pipeline.
- (2) If an *access arrangement period* follows immediately on the conclusion of a preceding *access arrangement period*, the opening capital base for the later *access arrangement period* is to be:
- (a) the opening capital base as at the commencement of the earlier *access arrangement period* (adjusted for any difference between estimated and actual capital expenditure included in that opening capital base);
- plus:
- (b) conforming capital expenditure made, or to be made, during the earlier *access arrangement period*;
- plus:
- (c) any amounts to be added to the capital base under rule 82, 84 or 86;
- less:
- (d) depreciation over the earlier *access arrangement period* (to be calculated in accordance with any relevant provisions of the access arrangement

governing the calculation of depreciation for the purpose of establishing the opening capital base); and

**Note:**

See rule 90.

- (e) redundant assets identified during the course of the earlier *access arrangement period*; and
  - (f) the value of pipeline assets disposed of during the earlier *access arrangement period*.
- (3) If a period intervenes between *access arrangement periods* during which the pipeline is not subject to a full access arrangement, the opening capital base for the later *access arrangement period* is to be:
- (a) the opening capital base determined in accordance with these rules for a notional access arrangement taking effect at the end of the *access arrangement period* for the last full access arrangement (the **relevant date**);
- plus:
- (b) the amount of capital expenditure since the relevant date;
- less:
- (c) depreciation since the relevant date; and
  - (d) the value of pipeline assets disposed of since the relevant date.

## 78 Projected capital base

The projected capital base for a particular period is:

- (a) the opening capital base;
- plus:
- (b) forecast conforming capital expenditure for the period;
- less:
- (c) forecast depreciation for the period; and
  - (d) the forecast value of pipeline assets to be disposed of in the course of the period.

## 79 New capital expenditure criteria

- (1) Conforming capital expenditure is capital expenditure that conforms with the following criteria:



- (a) the capital expenditure must be such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of providing services;
  - (b) the capital expenditure must be justifiable on a ground stated in subrule (2).
- (2) Capital expenditure is justifiable if:
- (a) the overall economic value of the expenditure is positive; or
  - (b) the present value of the expected incremental revenue to be generated as a result of the expenditure exceeds the present value of the capital expenditure; or
  - (c) the capital expenditure is necessary:
    - (i) to maintain and improve the safety of services; or
    - (ii) to maintain the integrity of services; or
    - (iii) to comply with a regulatory obligation or requirement; or
    - (iv) to maintain the service provider's capacity to meet levels of demand for services existing at the time the capital expenditure is incurred (as distinct from projected demand that is dependent on an expansion of pipeline capacity); or
  - (d) the capital expenditure is an aggregate amount divisible into 2 parts, one referable to incremental services and the other referable to a purpose referred to in paragraph (c), and the former is justifiable under paragraph (b) and the latter under paragraph (c).
- (3) In deciding whether the overall economic value of capital expenditure is positive, consideration is to be given only to economic value directly accruing to the service provider, gas producers, users and end users.
- (4) In determining the present value of expected incremental revenue:
- (a) a tariff will be assumed for incremental services based on (or extrapolated from) prevailing reference tariffs or an estimate of the reference tariffs that would have been set for comparable services if those services had been reference services; and
  - (b) incremental revenue will be taken to be the gross revenue to be derived from the incremental services less incremental operating expenditure for the incremental services; and
  - (c) a discount rate is to be used equal to the rate of return implicit in the reference tariff.

- (5) If capital expenditure made during an *access arrangement period* conforms, in part, with the criteria laid down in this rule, the capital expenditure is, to that extent, to be regarded as conforming capital expenditure.
- (6) The AER's discretion under this rule is limited.

**Note:**

See rule 40(2).

## **80 AER's power to make advance determination with regard to future capital expenditure**

- (1) The AER may, on application by a service provider, make a determination to the effect that, if capital expenditure is made in accordance with proposals made by the service provider and specified in the determination, the expenditure will meet the new capital expenditure criteria.
- (2) The AER may (but is not required to) engage in public consultation before making a determination under subrule (1).
- (3) A determination under subrule (1) is binding on the AER but a *decision* not to make such a determination creates no presumption that future expenditure will not meet the relevant criteria.

## **81 Non-conforming capital expenditure**

A service provider may make, during an *access arrangement period*, capital expenditure that is, in whole or in part, non-conforming capital expenditure.

## **82 Capital contributions by users to new capital expenditure**

- (1) A user may make a capital contribution towards a service provider's capital expenditure.
- (2) Capital expenditure to which a user has contributed may, with the AER's approval, be rolled into the capital base for a pipeline but, subject to subrule (3), not to the extent of any such capital contribution.
- (3) The AER may approve the rolling of capital expenditure (including a capital contribution made by a user, or part of such a capital contribution) into the capital base for a pipeline on condition that the access arrangement contain a mechanism to prevent the service provider from benefiting, through increased revenue, from the user's contribution to the capital base.

## **83 Surcharges**

- (1) When the service provider makes non-conforming capital expenditure, it may notify the AER that it proposes to recover the amount, or part of the amount, of the expenditure by means of a surcharge.

**Note:**

A surcharge may be proposed even where the non-conforming capital expenditure has been funded in whole or part by a user.

- (2) A surcharge is a charge, approved by the AER, in addition to a reference tariff (or other tariff):
  - (a) to be levied on users of incremental services; and
  - (b) designed to recover non-conforming capital expenditure or a specified portion of non-conforming capital expenditure.
- (3) To the extent that non-conforming capital expenditure is, or is to be, recovered by means of the surcharge, it can never be rolled into the capital base.
- (4) The AER must not approve a surcharge unless satisfied that the amount to be recovered from the surcharge does not exceed (in present value terms) the amount of the non-conforming capital expenditure that would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of providing services.
- (5) The AER may (but is not required to) engage in public consultation before approving a surcharge.
- (6) The AER's approval of a surcharge is binding on an arbitrator in an access dispute.

## **84 Speculative capital expenditure account**

- (1) A full access arrangement may provide that the amount of non-conforming capital expenditure, to the extent that it is not to be recovered through a surcharge on users or a capital contribution, is to be added to a notional fund (the **speculative capital expenditure account**).
- (2) The balance of the speculative capital expenditure account increases annually at a rate, determined at the AER's discretion, which may, but need not, be the rate of return implicit in a reference tariff.
- (3) If at any time the type or volume of services changes so that capital expenditure that did not, when made, comply with the new capital expenditure criteria becomes compliant, the relevant portion of the speculative capital expenditure account (including the return referable to that portion of the account) is to be withdrawn from the account and rolled into the capital base as at the commencement of the next *access arrangement period*.

## 85 Capital redundancy

- (1) A full access arrangement may include (and the AER may require it to include) a mechanism to ensure that assets that cease to contribute in any way to the delivery of pipeline services (redundant assets) are removed from the capital base.
- (2) A reduction of the capital base in accordance with such a mechanism may only take effect from the commencement of the first *access arrangement period* to follow the inclusion of the mechanism in the access arrangement or the commencement of a later *access arrangement period*.
- (3) An applicable access arrangement may include a mechanism for sharing costs associated with a decline in demand for pipeline services between the service provider and users.
- (4) Before requiring or approving a mechanism under this rule, the AER must take into account the uncertainty such a mechanism would cause and the effect the uncertainty would have on the service provider, users and prospective users.

## 86 Re-use of redundant assets

- (1) Subject to the new capital expenditure criteria, if, after the reduction of the capital base by the value of assets identified as redundant, the assets later contribute to the delivery of pipeline services, the assets may be treated as new capital expenditure of an amount calculated by taking their value as at the time of their removal from the capital base and increasing it annually at the rate of return implicit in the reference tariff.
- (2) To the extent the new capital expenditure criteria allow, the amount arrived at under subrule (1) will be returned to the capital base in accordance with those criteria.

## Division 5 Rate of return

### 87 Rate of return

~~(1) The rate of return on capital is to be commensurate with prevailing conditions in the market for funds and the risks involved in providing reference services.~~

[9.1]

(1) The rate of return for a service provider for an access arrangement period is the cost of capital as measured by the return required by investors in a commercial enterprise with a similar nature and degree of non-diversifiable risk as that faced by the service provider and must be calculated:

[9.1]

(a) as a nominal vanilla weighted average cost of capital (WACC) in accordance with the following formula:

[9.1]

$$\underline{WACC = k_e \frac{E}{V} + k_d \frac{D}{V}}$$

[9.1]

where: [9.1]

$k_e$  is the return on equity (determined using the Capital Asset Pricing Model) and is calculated as: [9.1]

$r_f + \beta_e \times \text{MRP}$  [9.1]

where: [9.1]

$r_f$  is the nominal risk free rate for the access arrangement period; [9.1]

$\beta_e$  is the equity beta; and [9.1]

MRP is the market risk premium; [9.1]

$k_d$  is the return on debt and is calculated as: [9.1]

$r_f + \text{DRP}$  [9.1]

where: [9.1]

DRP is the debt risk premium for the access arrangement period; [9.1]

E/V is the market value of equity as a proportion of the market value of equity and debt, which is  $1 - D/V$ ; and [9.1]

D/V is the market value of debt as a proportion of the market value of equity and debt; and [9.1]

(b) in accordance with the statement on the cost of capital. [9.1]

~~(2) In determining a rate of return on capital:~~ [9.1]

~~(a) it will be assumed that the service provider:~~ [9.1]

~~(i) meets benchmark levels of efficiency; and~~ [9.1]

~~(ii) uses a financing structure that meets benchmark standards as to gearing and other financial parameters for a going concern and reflects in other respects best practice; and~~ [9.1]

~~(b) a well accepted approach that incorporates the cost of equity and debt, such as the Weighted Average Cost of Capital, is to be used; and a well accepted financial model, such as the Capital Asset Pricing Model, is to be used.~~ [9.1]

**87A Review of the rate of return** [9.2]

(1) The AER must, in accordance with paragraph (8), carry out reviews of the matters referred to in paragraph (4). [9.2]

- (2) A first review is to be concluded by 1 March 2014 and further reviews are to follow at intervals not exceeding, in any case, five years with the first interval starting from 1 March 2014. [9.2]
- (3) The AER must, in consequence of a review, issue a statement (a statement on the cost of capital) adopting values and methods for service providers or for specified classes of service providers. [9.2]
- (4) The following matters referred to in rule 87(1)(a) and 87B (and the method of their calculation) may form the subject of a review: [9.2]
- (a) the nominal risk free rate; [9.2]
  - (b) the equity beta; [9.2]
  - (c) the market risk premium; [9.2]
  - (d) the debt risk premium; [9.2]
  - (e) the ratio of the value of debt to the value of equity; and [9.2]
  - (f) the assumed utilisation of imputation credits. [9.2]
- (5) In undertaking a review, the AER must have regard to: [9.2]
- (a) the need for the overall rate of return calculated for the purposes of rule 87(1)(a) to be a forward looking rate of return that is commensurate with prevailing conditions in the market for funds and the risk involved in providing pipeline services; [9.2]
  - (b) the need for the return on debt to reflect the current cost of borrowings for comparable debt; [9.2]
  - (c) the need for the values attributable to, or the methods of calculating, the matters referred to in paragraph (4) that vary according to the efficiency of the service provider to be based on a benchmark efficient service provider; [9.2]
  - (d) the need to achieve an outcome that is consistent with the national gas objective; and [9.2]
  - (e) the previously adopted values for or methods of calculating the matters referred to in paragraph (4). [9.2]
- (6) A statement on the cost of capital applies only for the purposes of an *access arrangement proposal* submitted to the AER after publication of the statement on the cost of capital. [9.2]
- (7) An access arrangement to which a statement on the cost of capital is applicable must be consistent with the statement. [9.2]
- (8) In carrying out a review under this rule: [9.2]
- (a) the AER must publish: [9.2]

- (i) the proposed values or methods of calculating the matters referred to in paragraph (4); [9.2]
- (ii) an explanatory statement that sets out the reasons for the proposed values or methods of calculating the matters referred to in paragraph (4); and [9.2]
- (iii) an invitation for written submissions on the for the proposed values or methods of calculating the matters referred to in paragraph (4). [9.2]
- (b) The invitation must allow no less than 30 business days for the making of submissions, and the AER is not required to consider any submission made pursuant to that invitation after this time period has expired. [9.2]
- (c) The AER may publish such issues, consultation and discussion papers, and hold such conferences and information sessions, in relation to the proposed values or methods of calculating the matters referred to in paragraph (4) as it considers appropriate. [9.2]
- (d) Within 100 business days of publishing the documents referred to in paragraph (a), the AER must publish, in relation to the values or matters of calculating the matters referred to in paragraph (4): [9.2]

  - (i) its final decision including its reasons; and [9.2]
  - (ii) notice of the making of the final decision. [9.2]
- (e) Subject to paragraph (b), the AER must, in making its final decision referred to in subparagraph (d)(i), consider any submissions made pursuant to the invitation for submissions referred to in subparagraph (a)(iii), and the reasons referred to in subparagraph (d)(i) must include: [9.2]

  - (i) a summary of each issues raised in those submissions that the AER reasonably considers to be material; and [9.2]
  - (ii) the AER’s response to each such issue. [9.2]

**Division 5A Estimated cost of corporate income tax** [9.3]

**87B Estimated cost of corporate income tax** [9.3]

- (1) The estimated cost of corporate income tax of a service provider for each year (ETC<sub>t</sub>) must be calculated: [9.3]

  - (a) in accordance with the following formula: [9.3]

$$ETC_t = (ETI_t \times r_t) (1 - \gamma)$$
 [9.3]

where: [9.3]

ETI<sub>t</sub> is an estimate of the taxable income for that year that would be earned by a benchmark service provider a result of the provision of reference services; [9.3]

r<sub>t</sub> is the expected statutory income tax rate for that year as determined by the AER; and [9.3]

γ is the assumed utilisation of imputation credits; [9.3]

(b) in accordance with the statement on the cost of capital. [9.3]

(2) For these purposes: [9.3]

(a) the cost of debt must be based on that of a benchmark efficient service provider; and [9.3]

(b) the estimate must take into account the estimated depreciation for that year for tax purposes, for a benchmark efficient service provider, of assets where the value of those assets is included in the capital base for that year. [9.3]

## **Division 6          Depreciation**

### **88          Depreciation schedule**

- (1) The depreciation schedule sets out the basis on which the pipeline assets constituting the capital base are to be depreciated for the purpose of determining a reference tariff.
- (2) The depreciation schedule may consist of a number of separate schedules, each relating to a particular asset or class of assets.

### **89          Depreciation criteria**

- (1) The depreciation schedule should be designed:
  - (a) so that reference tariffs will vary, over time, in a way that promotes efficient growth in the market for reference services; and
  - (b) so that each asset or group of assets is depreciated over the economic life of that asset or group of assets; and
  - (c) so as to allow, as far as reasonably practicable, for adjustment reflecting changes in the expected economic life of a particular asset, or a particular group of assets; and
  - (d) so that (subject to the rules about capital redundancy), an asset is depreciated only once (ie that the amount by which the asset is depreciated over its economic life does not exceed the value of the asset at the time of its inclusion in the capital base (adjusted, if the accounting method approved by the AER permits, for inflation)); and



- (e) so as to allow for the service provider's reasonable needs for cash flow to meet financing, non-capital and other costs.
- (2) Compliance with subrule (1)(a) may involve deferral of a substantial proportion of the depreciation, particularly where:
  - (a) the present market for pipeline services is relatively immature; and
  - (b) the reference tariffs have been calculated on the assumption of significant market growth; and
  - (c) the pipeline has been designed and constructed so as to accommodate future growth in demand.
- (3) The AER's discretion under this rule is limited.

**Note:**

See rule 40(2).

**90 Calculation of depreciation for rolling forward capital base from one access arrangement period to the next**

- (1) A full access arrangement must contain provisions governing the calculation of depreciation for establishing the opening capital base for the next *access arrangement period* after the one to which the access arrangement currently relates.
- (2) The provisions must resolve whether depreciation of the capital base is to be based on forecast or actual capital expenditure.

**Division 7 Operating expenditure**

**91 Criteria governing operating expenditure**

- (1) Operating expenditure must be such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services.
- (2) The AER's discretion under this rule is limited.

**Note:**

See rule 40(2).

## Division 8 Tariffs

### 92 Revenue equalisation

- (1) A full access arrangement must include a mechanism (a *reference tariff variation mechanism*) for variation of a reference tariff over the course of an *access arrangement period*.
- (2) The *reference tariff variation mechanism* must be designed to equalise (in terms of present values):
  - (a) forecast revenue from reference services over the *access arrangement period*; and
  - (b) the portion of total revenue allocated to reference services for the *access arrangement period*.
- (3) However, if there is an interval (the **interval of delay**) between a revision commencement date stated in a full access arrangement and the date on which revisions to the access arrangement actually commence:
  - (a) reference tariffs, as in force at the end of the previous *access arrangement period*, continue without variation for the interval of delay; but
  - (b) the operation of this subrule may be taken into account in fixing reference tariffs for the new *access arrangement period*.

### 93 Allocation of total revenue and costs

- (1) Total revenue is to be allocated between reference and other services in the ratio in which costs are allocated between reference and other services.
- (2) Costs are to be allocated between reference and other services as follows:
  - (a) costs directly attributable to reference services are to be allocated to those services; and
  - (b) costs directly attributable to pipeline services that are not reference services are to be allocated to those services; and
  - (c) other costs are to be allocated between reference and other services on a basis (which must be consistent with the revenue and pricing principles) determined or approved by the AER.
- (3) The AER may, however, permit the allocation of the costs of rebateable services, in whole or part, to reference services if:
  - (a) the AER is satisfied that the service provider will apply an appropriate portion of the revenue generated from the sale of rebateable services to provide price rebates (or refunds) to the users of reference services; and

- (b) any other conditions determined by the AER are satisfied.
- (4) A pipeline service is a **rebateable service** if:
  - (a) the service is not a reference service; and
  - (b) substantial uncertainty exists concerning the extent of the demand for the service or of the revenue to be generated from the service; and
  - (c) the market for the service is substantially different from the market for any reference service.

## 94 Tariffs – distribution pipelines

- (1) For the purpose of determining reference tariffs, customers for reference services provided by means of a distribution pipeline must be divided into tariff classes.
- (2) A tariff class must be constituted with regard to:
  - (a) the need to group customers for reference services together on an economically efficient basis; and
  - (b) the need to avoid unnecessary transaction costs.
- (3) For each tariff class, the revenue expected to be recovered should lie on or between:
  - (a) an upper bound representing the stand alone cost of providing the reference service to customers who belong to that class; and
  - (b) a lower bound representing the avoidable cost of not providing the reference service to those customers.
- (4) A tariff, and if it consists of 2 or more charging parameters, each charging parameter for a tariff class:
  - (a) must take into account the long run marginal cost for the reference service or, in the case of a charging parameter, for the element of the service to which the charging parameter relates;
  - (b) must be determined having regard to:
    - (i) transaction costs associated with the tariff or each charging parameter; and
    - (ii) whether customers belonging to the relevant tariff class are able or likely to respond to price signals.
- (5) If, however, as a result of the operation of subrule (4), the service provider may not recover the expected revenue, the tariffs must be adjusted to ensure recovery

of expected revenue with minimum distortion to efficient patterns of consumption.

- (6) The AER's discretion under this rule is limited.

## **95 Tariffs – transmission pipelines**

- (1) A tariff for a reference service provided by means of a transmission pipeline must be designed:
- (a) to generate from the provision of each reference service the portion of total revenue referable to that reference service; and
  - (b) as far as is practicable consistently with paragraph (a), to generate from the user, or the class of users, to which the reference service is provided, the portion of total revenue referable to providing the reference service to the particular user or class of users.
- (2) The portion of total revenue referable to a particular reference service is determined as follows:
- (a) costs directly attributable to each reference service are to be allocated to that service; and
  - (b) other costs attributable to reference services are to be allocated between them on a basis (which must be consistent with the revenue and pricing principles) determined or approved by the AER.
- (3) The portion of total revenue referable to providing a reference service to a particular user or class of users is determined as follows:
- (a) costs directly attributable to supplying the user or class of users are to be allocated to the relevant user or class; and
  - (b) other costs are to be allocated between the user or class of users and other users or classes of users on a basis (which must be consistent with the revenue and pricing principles) determined or approved by the AER.
- (4) The AER's discretion under this rule is limited.

**Note:**

See rule 40(2).

## **96 Prudent discounts**

- (1) Despite the other provisions of this Division, the AER may, on application by a service provider, approve a discount for a particular user or prospective user or a particular class of users or prospective users.
- (2) The AER may only approve a discount under this rule if satisfied that:

- (a) the discount is necessary to:
  - (i) respond to competition from other providers of pipeline services or other sources of energy; or
  - (ii) maintain efficient use of the pipeline; and
- (b) the provision of the discount is likely to lead to reference or equivalent tariffs lower than they would otherwise have been.

**Note:**

Even though a user's incremental load is retained at a discounted price, overall tariffs may be lower because of the user's contribution to fixed costs.

- (3) If the AER approves a discount under this rule, the AER may also approve allocation of the cost, or part of the cost, of providing the discount to the costs of providing a reference or other service in one or more future *access arrangement periods*.
- (4) In this rule:

**equivalent tariff** means the tariff that is likely to have been set for a service that is not a reference service if the service had been a reference service.

## 97 Mechanics of reference tariff variation

- (1) A *reference tariff variation mechanism* may provide for variation of a reference tariff:
  - (a) in accordance with a schedule of fixed tariffs; or
  - (b) in accordance with a formula set out in the access arrangement; or
  - (c) as a result of a cost pass through for a defined event (such as a cost pass through for a particular tax); or
  - (d) by the combined operation of 2 or more of the above.
- (2) A formula for variation of a reference tariff may (for example) provide for:
  - (a) variable caps on the revenue to be derived from a particular combination of reference services; or
  - (b) tariff basket price control; or
  - (c) revenue yield control; or
  - (d) a combination of all or any of the above.
- (3) In deciding whether a particular *reference tariff variation mechanism* is appropriate to a particular access arrangement, the AER must have regard to:

- (a) the need for efficient tariff structures; and
  - (b) the possible effects of the *reference tariff variation mechanism* on administrative costs of the AER, the service provider, and users or potential users; and
  - (c) the regulatory arrangements (if any) applicable to the relevant reference services before the commencement of the proposed *reference tariff variation mechanism*; and
  - (d) the desirability of consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction); and
  - (e) any other relevant factor.
- (4) A *reference tariff variation mechanism* must give the AER adequate oversight or powers of approval over variation of the reference tariff.
- (5) Except as provided by a *reference tariff variation mechanism*, a reference tariff is not to vary during the course of an *access arrangement period*.

## **Division 9            Incentive mechanisms**

### **98            Incentive mechanism**

- (1) A full access arrangement may include (and the AER may require it to include) one or more incentive mechanisms to encourage efficiency in the provision of services by the service provider.
- (2) An incentive mechanism may provide for carrying over increments for efficiency gains and decrements for losses of efficiency from one *access arrangement period* to the next.
- (3) An incentive mechanism must be consistent with the revenue and pricing principles.

## **Division 10          Fixed principles**

### **99            Fixed principles**

- (1) A full access arrangement may include a principle declared in the access arrangement to be fixed for a stated period.
- (2) A principle may be fixed for a period extending over 2 or more *access arrangement periods*.
- (3) A fixed principle approved before the commencement of these rules, or approved by the AER under these rules, is binding on the AER and the service provider for the period for which the principle is fixed.

- (4) However:
  - (a) the AER may vary or revoke a fixed principle at any time with the service provider's consent; and
  - (b) if a rule is inconsistent with a fixed principle, the rule operates to the exclusion of the fixed principle.

