

Constraints imposed by the transitional rules

Endeavour Energy's transitional regulatory proposal must comply with the requirements of the transitional rules.¹ Two provisions of these rules however constrained Endeavour Energy in giving full effect to the AER's classification of services applicable from 1 July 2014. The relevant provisions are:

- For the purpose of the application of clause 6.15.2(7) of the transitional chapter 6, the transitional regulatory control period must be treated as if it were the last regulatory year of the current regulatory control period, and not as a separate regulatory control period.²
- Clause 6.15.2(7) states that costs which have been allocated to a particular service cannot be reallocated to another service during the course of a regulatory control period.

The combined effect of the above clauses mean that the way costs are allocated in the current 2009-14 period must be maintained for the transitional year. In other words, costs cannot be reallocated between standard control services and newly classified alternative control services in the transitional year. Complying with the above requirements of the Rules however means that full effect cannot be given to the AER's classification of services for the transitional year.

AER's preferred approach

Endeavour Energy, through Networks NSW, have had discussions with the AER's on the approach to fulfilling the Rules requirements for the transitional proposal, particularly the provision of indicative prices. On 11 December 2013, the AER wrote to Networks NSW outlining their view of a preferred approach to setting indicative prices for the transitional year.³ The AER's letter stated that:

*This letter sets out the views of the AER staff on this topic (i.e. how alternative control services prices should be set for the transitional regulatory year). These views have not been endorsed by the AER and are provided by staff to assist you in formulating your views. (However) our preferred approach... seeks to comply with the rules and minimise significant changes that would impact on customers in the transitional year. In practical terms it makes sense for as few changes as possible to be made in the transitional year. This is because there will be limited or no opportunity to consult with the stakeholders on any potential changes.*⁴

We understand the approach preferred by the AER is:

- Public lighting services: prices for the transitional year are the 2013-14 prices escalated by CPI as at the end of the current regulatory period. This is to comply with clause 11.56.3(j) of the Rules, Endeavour Energy's transitional proposal was already being prepared on this basis as the rules are clear for these service which are currently classified as alternative control during the current regulatory control period. .
- Metering type 5-6: the AER considers that new prices should not be established for the transitional year as the transitional rules prevent the re-allocation of costs from standard control service to alternative control service for the transitional year. Instead we understand that the AER prefers to leave the costs of providing type 5-6 metering services within the standard control services cost pool and these costs are to be recouped through prices for standard control services (i.e. DUOS prices). This approach is the same as how metering type 5-6 services costs are being recovered in the current period (because they are classified as standard control services for the current period).
- For those ancillary network services currently being provided and have existing prices, the AER prefers to apply CPI to these prices, as required by clause 11.56.3(j) of the Rules.
- For those ancillary network services currently being provided but there are no existing prices and the costs are currently captured as part of the standard control service cost pool (because these services are classified as standard control services for the current period), the AER prefers to leave the costs of providing these services in the standard control services cost and recovered through DUOS prices for the transitional year.
- For new ancillary services (i.e. those not being provided for the current period) new cost reflective prices should be established.

¹ Clause 11.56.2(a) of the Rules.

² Clause 11.56.3(i)

³ Letter from the General Manager, Network Regulation, AER.

⁴ AER's letter of 11 December 2013, pp1-2.

Endeavour Energy's consideration

We agree with the AER that the transitional rules are complex and contain an anomaly that renders the preparation of the transitional proposal more complicated than initially envisaged. In the interest of minimising changes in the transitional year, Endeavour Energy has adopted the substance of the AER's approach. Of significance, we note the AER's view that its preferred approach complies with the Rules and on this basis we consider that Endeavour Energy's compliance with the rules will not be jeopardised in implementing the substance of the approach preferred by the AER.

However to avoid any unintended consequences of this approach and to provide clarity for the regulatory proposals of the subsequent regulatory period (and the AER's determination thereof) Endeavour Energy considers the following clarification must be made to the scope of this approach. These clarifications are necessary because the AER's approach effectively seeks to maintain the status quo despite the reclassification of some services from 1 July 2014. The clarifications needed are:

- a) The AER's classification of services applicable from 1 July 2014 (as per the F&A stage 1) remains applicable.
- b) Endeavour Energy will propose an amount to be the annual revenue requirement for standard control services for the transitional year (as required by 6.8.2 and amended by 11.55.2(b)). The AER will make a constituent decision on this amount as required under 11.56.1(b) and in accordance with 11.56.3(b) to (f).
- c) For the purpose of complying with clause 11.56.2(b)(6), Endeavour Energy will provide a summary of the plans for expenditure for standard control services only, as they are defined in the AER's stage 1 F&A.
- d) This amount (as accepted or determined by the AER) will be the amount used for:
 - i. Adjusting the annual revenue requirement of the subsequent period as set out in 11.56.4(h). To avoid doubt, this amount will be the amount for the purpose of clause 11.56.4(i)(1).
 - ii. Calculating the over/under recovery of revenue (as compared to actual revenue) in the transitional year in demonstrating compliance with the control mechanism for standard control services from applicable from 1 July 2014.

Endeavour Energy considers the above clarifications are consistent with the AER's view as outlined in its letter of 11 December 2013, the AER contemplated the clear delineation of revenues associated with the provision of standard control services and alternative control services. The AER stated that:

A reconciliation of the costs of these services (i.e. type 5-6 metering services) will be required to the extent that the standard control building blocks require an adjustment as part of the AER's final distribution determination for the subsequent regulatory control period.

We set out further details and examples of how the adjustment and calculation of over and under recovery would operate in chapter 6 above.

- e) Endeavour Energy will add to the revenue amount proposed to be the annual revenue requirement for standard control services for the transitional year, the revenue needed to recover the costs of providing reclassified alternative control services and unclassified services (as they are defined in the AER's F&A stage 1 paper). For clarity, public lighting revenues will not be 'bundled'.

This 'bundled' revenue⁵ will be nominated as the total revenue to be recovered through DUOS charges for the transitional year. This amount will be effectively be accepted or otherwise amended by the AER in its transitional determination.

For avoidance of doubt, the total bundled amount only has the effect of setting DUOS charges for the transitional year and nothing else.

We note that this bundled revenue includes the costs of emergency recoverable works for transitional year (net of any revenue expected to be recovered through third parties). This

⁵ Net of revenues expected from separate miscellaneous and monopoly prices and from third party damage recovery.

inclusion was not raised by the AER in its letter of 11 December 2103. The AER's approach rests on the fact that the rules prevent the re-allocation of costs between services in the transitional year. For this same reason, we consider that costs relating to emergency recoverable works, which are classified as standard control services in the current period but unclassified by the AER from 1 July 2014 should also be left in the standard control services costs pool in the transitional year and recovered through the bundled DUOS charges for the transitional year.

Further, in relation to this 'aggregation' of revenue in the transitional year, it must be noted that:

- i. The fact that revenues needed to recover costs relating to alternative control services (e.g. type 5-6 metering services) and unclassified services) does not render ineffective the AER's classification of these services from 1 July 2014 onwards.
- ii. The bundled revenue⁶ will not to be used in adjusting the annual revenue requirement of standard control services of the subsequent period (as per clause 11.56.4(h)-(j)) or in calculating the over/under of standard control services revenue for the transitional year.
- iii. The aggregation of revenues is for the transitional year only and only for the purpose of setting the DUOS prices of this year. In relation to the requirements of clause 11.56.2(b)(5), the indicative revenue requirements for the transitional year and the subsequent four years will be the revenue relating to the provision of standard control services (as they are defined in the AER's stage 1 F&A).
- iv. The recovery of revenue needed to cover the costs of providing reclassified alternative control services in DUOS prices is for the transitional year only and that an adjustment will be made to the prices for alternative control services in the subsequent period for under/over recovery of alternative control services in the transitional year. Separate alternative control prices will be established for the period subsequent to the transitional control period.

⁶ i.e. the total revenue aggregated from the annual revenue requirement for standard control services and the revenues needed to recover the costs of alternative control services and unclassified services.