



Draft decision

Directlink transmission determination

2015-16 to 2019-20

**Attachment 12: Pricing methodology and
negotiated services**

November 2014

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Note

This attachment forms part of the AER's draft decision on Directlink's revenue proposal 2015–20. It should be read with other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – maximum allowed revenue

Attachment 2 – regulatory asset base

Attachment 3 – rate of return

Attachment 4 – value of imputation credits

Attachment 5 – regulatory depreciation

Attachment 6 – capital expenditure

Attachment 7 – operating expenditure

Attachment 8 – corporate income tax

Attachment 9 – efficiency benefit sharing scheme

Attachment 10 – capital expenditure sharing scheme

Attachment 11 – service target performance incentive scheme

Attachment 12 – pricing methodology and negotiated services

Attachment 13 – pass through events

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Shortened forms

Shortened form	Extended form
AARR	aggregate annual revenue requirement
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ASRR	aggregate service revenue requirement
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
MAR	maximum allowed revenue
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
NTSC	negotiated transmission service criteria

Shortened form	Extended form
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
TNSP	transmission network service provider
TUoS	transmission use of system
WACC	weighted average cost of capital

12 Pricing methodology and negotiated services

This chapter set outs our determination on Directlink's proposed pricing methodology¹ and negotiating framework² for the 2015–20 regulatory control period.³ We also specify the negotiated transmission service criteria (NTSC) that are to apply to Directlink.⁴

Our transmission determination imposes control over revenues that a transmission network service provider (TNSP) can recover from the provision of prescribed transmission services. A pricing methodology describes a formula, process or approach that a TNSP uses to allocate the aggregate annual revenue requirement to those categories of prescribed transmission services provided by the TNSP and to transmission network connection points of network users.⁵ The methodology also determines the structure of the tariffs that a TNSP may charge for each of the categories of prescribed transmission services.⁶

By contrast, the provision of negotiated transmission services is less directly regulated by the AER. Instead, under the National Electricity Rules (NER), these services are subject to negotiation between parties, or alternatively arbitration and dispute resolution by a commercial arbitrator.

For the purpose of facilitating such negotiation and arbitration, a transmission business must prepare, for AER approval, a negotiating framework which sets out procedures for negotiating the terms and conditions of access to a negotiated transmission service.⁷ In addition, the AER specifies for each transmission business the negotiated transmission service criteria (NTSC) that it must apply in negotiating terms and conditions of access, including the prices and access charges for negotiated transmission services.⁸ They also contain the criteria that a commercial arbitrator must apply to resolve disputes about such terms and conditions and/or access charges.⁹

12.1 Draft decision

The AER's draft decision:

- does not accept Directlink's proposed pricing methodology
- approves Directlink's proposed negotiating framework
- specifies a proposed NTSC.

12.2 Directlink's proposal

In accordance with the NER, Directlink submitted its proposed negotiating framework and pricing methodology with its revenue proposal for the 2015–20 regulatory control period.¹⁰ Concurrently, we published on our website the AER's proposed NTSC that would apply to Directlink (reproduced in section 12.4.2). This is required by clause 6A.11.3 of the NER.¹¹ We acknowledge that there are

¹ NER, clause 6A.2.2(4); 6A.14.1(8)

² NER, clause 6A.2.2(2); 6A.14.1(6)

³ NER, clause 6A.2.2(3); 6A.14.1(7).

⁴ NER, clause 6A.2.2(3).

⁵ NER, clause 6A.24.1(b)(1).

⁶ NER, clause 6A.24.1(b)(2).

⁷ NER, clause 6A.9.5(a).

⁸ NER, clause 6A.9.4(a)(1).

⁹ NER, clause 6A.9.4(a)(2).

¹⁰ NER, clause 6A.10.1. Directlink submitted its revenue proposal to the AER on 2 June 2014.

¹¹ AER, *Proposed negotiating transmission service criteria for Directlink, regulatory control period 1 July 2015 to 30 June 2020*, June 2014.

currently no negotiated services associated with Directlink.¹² Nonetheless, Directlink must submit a proposed negotiating framework, which we either refuse or accept, and we are to specify an NTSC.

12.3 Assessment approach

In reaching our draft decision, we considered whether:

- the proposed pricing methodology gives effect to the pricing principles for prescribed transmission services and complies with the information requirements of the pricing methodology guidelines¹³
- the proposed negotiating framework specified the minimum requirements in clause 6A.9.5(c) of the NER¹⁴
- the NTSC sets out the required criteria and reflects the negotiated transmission service principles in clause 6A.9.1 of the NER.¹⁵

12.4 Reasons for draft decision

We do not approve Directlink's proposed pricing methodology.

We approve Directlink's proposed negotiating framework.

The NTSC we published on our website in June 2014 are consistent with the Negotiated Transmission Service Principles and will apply to Directlink.

12.4.1 Pricing methodology

We do not approve Directlink's proposed pricing methodology.

Much of Directlink's proposal includes aspects of the pricing methodology TransGrid proposed for its 2015–18 regulatory control period. Our draft decision for TransGrid is not to accept its pricing methodology. It follows that we do not accept Directlink's methodology for the same reasons. We expect that Directlink will engage with TransGrid about the changes it makes before submitting a revised pricing methodology.

Notwithstanding this, we accept that it is appropriate for Directlink to adopt aspects of TransGrid's pricing methodology. Where there are multiple transmission businesses in a region, those businesses must appoint a co-ordinating network service provider.¹⁶ In Directlink's case, it has appointed TransGrid. In accordance with the NER, TransGrid is therefore responsible for allocating all relevant aggregate annual revenue requirement (AARR) in its region (NSW).¹⁷ This includes Directlink's AARR. In such circumstances, we consider Directlink's adoption of aspects of TransGrid's proposal is appropriate.

We cannot, however, accept Directlink's proposal. It has adopted aspects of TransGrid's proposed pricing methodology which we have not accepted in our draft decision for TransGrid. For the same reasons, we do not accept these in this draft decision for Directlink. . These are as follows:

¹² Directlink, *Revenue proposal*, 2 June 2014, p. 14.

¹³ NER, clause 6A.23 and 6A.24; 6A.14.3(g)(1) and (2).

¹⁴ NER, clause 6A.9.5(b)(2); 6A.14.3(f).

¹⁵ NER, clause 6A.9.4(a) and (b); 6A.14.1(i)

¹⁶ NER, clause 6A.29.1(a).

¹⁷ NER, clause 6A.29.1(d).

- to be able to amend aspects of its approved pricing methodology during the regulatory control period
- for locational transmission use of system (TUoS) services, a switch to a 20 day system peak method of cost allocation
- for non-locational TUoS and common transmission services, basing prices on maximum demand and applying a side constraint equal to CPI + 3 per cent
- the availability to negotiate a fixed price with its transmission network customers.

Our reasons for not accepting these aspects of TransGrid's proposed pricing methodology are set out in our draft decision for TransGrid.¹⁸ We do not consider them to comply with the pricing principles in the NER or the pricing methodology guidelines.

We did not receive any submission on Directlink's proposed pricing methodology. But in our reasoning on TransGrid's proposed pricing methodology we did take into account a number of submissions, which are relevant to Directlink's proposal.¹⁹ Those submissions are discussed in our draft decision for TransGrid.²⁰

It is important to clarify how Directlink's and TransGrid's pricing methodologies will interact. We note that the lengths of the two businesses' regulatory control periods are different. Directlink's is from 1 July 2015 to 30 June 2020. TransGrid's regulatory control period has the same commencement date but ends on 30 June 2018.

We confirm that the aspects of TransGrid's 2015–18 pricing methodology which Directlink adopts will apply to Directlink for its entire 2015–20 regulatory control period. To avoid any doubt, if TransGrid submits a modified pricing methodology for its next regulatory control period (2018–19 and beyond), those modification will not apply to Directlink in 2018–20. This is consistent with the NER requirement that the same pricing methodology applies to a business for the duration of its regulatory control period.²¹

12.4.2 Negotiating framework

The AER approves the proposed negotiating framework because it satisfies the requirements set out in clause 6A.9.5(c) of the NER. The AER's assessment is summarised in Table 12.1.

Table 12.1 AER's assessment of the negotiating framework proposed by Directlink

NER requirements	AER assessment
Requirement for Directlink and the applicant of a negotiated transmission service to negotiate in good faith—clause 6A.9.5(c)(1)	Paragraph 2 of Directlink's proposed negotiating framework satisfies this requirement.
Requirement for Directlink to provide all such commercial information reasonably required to enable the applicant of a negotiated transmission service to engage in effective	Paragraph 6 of Directlink's proposed negotiating framework satisfies this requirement.

¹⁸ AER, *Draft decision on TransGrid's 2015–18 regulatory control period*, 1 November 2014, XXX.

¹⁹ ElectraNet, *Submission on TransGrid's proposed pricing methodology*, 7 August 2014; MEU: *Submission on TransGrid's regulatory proposal*, August 2014; Norske Skog, *Submission on TransGrid's proposed pricing methodology*, August 2014; EUAA, *Submission on TransGrid's proposed pricing methodology*, August 2014; Bell Bay Aluminium, *Submission on TransGrid's proposed pricing methodology*, August 2014

²⁰ AER, *Draft decision on TransGrid's 2015–18 regulatory control period*, 1 November 2014, XXX.

²¹ NER, clause 6A.24.1(e) and (f).

negotiations—clause 6A.9.5(c)(2)	
Requirement for Directlink to identify and inform the negotiated transmission service applicant of the reasonable costs of providing the negotiated service; and demonstrate that charges reflect costs—clause 6A.9.5(c)(3)	Paragraph 6.1.3 of Directlink’s proposed negotiating framework satisfies this requirement.
Requirement for a negotiated transmission service applicant to provide all such commercial information reasonably required to enable Directlink to engage in effective negotiation—clause 6A.9.5(c)(4)	Paragraphs 4 and 5 of Directlink’s proposed negotiating framework satisfy this requirement.
Requirement to specify a reasonable period of time for commencing, progressing and finalising negotiations; and a requirement for each party to use its reasonable endeavours to adhere to those time periods during the negotiation—clause 6A.9.5(c)(5)	Paragraph 3 of Directlink’s proposed negotiating framework satisfies this requirement.
Requirement to specify a process for dispute to be dealt with in accordance with the relevant provisions for dispute resolution ²² —clause 6A.9.5(c)(6)	Paragraph 9 of Directlink’s proposed negotiating framework satisfies this requirement.
Requirement to specify arrangements for the payment of Directlink’s reasonable direct expenses incurred in processing the application to provide the negotiated transmission service—clause 6A.9.5(c)(7)	Paragraph 11 of Directlink’s proposed negotiating framework satisfies this requirement.
Requirement for Directlink to determine the potential impact of the provision of a negotiated transmission service on other network users—clause 6A.9.5(c)(8)	Paragraph 8 of Directlink’s proposed negotiating framework satisfies this requirement.
Requirement for Directlink to notify and consult with any affected network user and ensure the negotiated transmission service does not result in noncompliance with obligations in relation to other network users under the NER—clause 6A.9.5(c)(9)	Paragraph 8.2 of Directlink’s proposed negotiating framework satisfies this requirement.

Source: Directlink, *Proposed negotiating framework for 2015-20, May 2014*.

12.5 Negotiated transmission service criteria

Below we have set out the NTSC published by the AER in June 2014.²³ This NTSC will apply to Directlink. We consider that the NTSC sets out the required criteria to be applied by Directlink in negotiating terms and conditions of access for negotiated transmission services and any access charges. It also sets out the criteria to be applied by a commercial arbitrator in resolving any dispute in relation to those matters.²⁴ The NTSC give effect to and are consistent with the Negotiated Transmission Service Principles in clause 6A.9.1 of the NER²⁵

The NTSC

National Electricity Objective

1. The terms and conditions of access for a negotiated transmission service, including the price that is to be charged for the provision of that service and any access charges, should promote the achievement of the National Electricity Objective.

²² The relevant provisions for dispute resolution are set out in part K of chapter 6A of the NER.

²³ AER, *Proposed negotiating transmission service criteria for Directlink, regulatory control period 1 July 2015 to 30 June 2020*, June 2012.

²⁴ NER, clause 6A.9.4(a)

²⁵ NER, clause 6A.9.4(b)

Criteria for terms and conditions of access

Terms and conditions of access

2. The terms and conditions of access for a negotiated transmission service must be fair, reasonable and consistent with the safe and reliable operation of the power system in accordance with the NER.
3. The terms and conditions of access for negotiated transmission services, particularly any exclusions and limitations of liability and indemnities, must not be unreasonably onerous. Relevant considerations include the allocation of risk between the TNSP and the other party, the price for the negotiated transmission service and the cost to the TNSP of providing the negotiated service.
4. The terms and conditions of access for a negotiated transmission service must take into account the need for the service to be provided in a manner that does not adversely affect the safe and reliable operation of the power system in accordance with the NER.

Price of services

5. The price of a negotiated transmission service must reflect the cost that the TNSP has incurred or incurs in providing that service, and must be determined in accordance with the principles and policies set out in the Cost Allocation Methodology.
6. Subject to criteria 7 and 8, the price for a negotiated transmission service must be at least equal to the avoided cost of providing that service but no more than the cost of providing it on a stand alone basis.
7. If the negotiated transmission service is a shared transmission service that:
 - a. exceeds any network performance requirements which it is required to meet under any relevant electricity legislation; or
 - b. exceeds the network performance requirements set out in schedule 5.1a and 5.1 of the NER
8. then the difference between the price for that service and the price for the shared transmission service which meets network performance requirements must reflect the TNSP's incremental cost of providing that service (as appropriate).
9. For shared transmission services, the difference in price between a negotiated transmission service that does not meet or exceed network performance requirements and a service that meets those requirements should reflect the TNSP's avoided costs. Schedule 5.1a and 5.1 of the NER or any relevant electricity legislation must be considered in determining whether any network service performance requirements have not been met or exceeded.
10. The price for a negotiated transmission service must be the same for all Transmission Network Users. The exception is if there is a material difference in the costs of providing the negotiated transmission service to different Transmission Network Users or classes of Transmission Network Users.
11. The price for a negotiated transmission service must be subject to adjustment over time to the extent that the assets used to provide that service are subsequently used to provide services to another person. In such cases the adjustment must reflect the extent to which the costs of that asset are being recovered through charges to that other person.

12. The price for a negotiated transmission service must be such as to enable the TNSP to recover the efficient costs of complying with all regulatory obligations associated with the provision of the negotiated transmission service.

Criteria for access charges

Access charges

13. Any access charges must be based on the costs reasonably incurred by the TNSP in providing Transmission Network User access. This includes the compensation for forgone revenue referred to in clause 5.4A(h) to (j) of the NER and the costs that are likely to be incurred by a person referred to in clause 5.4A(h) to (j) of the NER (as appropriate).