Draft decision

TasNetworks transmission determination

2015-16 to 2018-19

Attachment 12: Pricing methodology

November 2014

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's draft decision on the transmission determination for TasNetworks' 2015–19 regulatory control period. It should be read in conjunction 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

Attachment 13 – pass through events

Attachment 14 – negotiated services

Contents

Shortened forms

Shortened form	Extended form
AARR	aggregate annual revenue requirement
AASB	Australian Accounting Standards Board
ABS	Australian Bureau of Statistics
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ARPC	Australian Reinsurance Pool Corporation
ASRR	aggregate service revenue requirement
ASX	Australian Stock Exchange
ATO	Australian Tax Office
augex	augmentation expenditure
Benchmarking report	AER, *Electricity transmission network service providers annual benchmarking report*, November 2014
capex	capital expenditure
capex incentive guideline	AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013
CCP	Consumer Challenge Panel
CEG	Competition Economics Group
CESS	capital expenditure sharing scheme
CPI	consumer price index
DAE	Deloitte Access Economic
DRP	debt risk premium

12 Pricing methodology

This attachment sets out the determination on TasNetworks' proposed pricing methodology for the 2015–19 regulatory control period.

A pricing methodology forms part of our transmission determination.[1] Its role is to answer the question 'who should pay how much'[2] in order for a transmission business to recover its costs. To do this, a pricing methodology must provide a 'formula, process or approach'[3] that when applied:

- allocates the aggregate annual revenue requirement to the categories of prescribed transmission services that a transmission business provides and to the connection points of network users[4]
- determines the structure of prices that a transmission business may charge for each category of prescribed transmission services.[5]

A pricing methodology relates to prescribed transmission services only. For negotiated services, TasNetworks must comply with other requirements, which are discussed in attachment 14 of this draft decision.

12.1 Draft decision

We approve TasNetworks' pricing methodology for the 2015–19 regulatory control period. This is because it gives effect to the pricing principles in the NER and complies with the information requirements set out in the pricing methodology guidelines.[6]

12.2 TasNetworks' proposal

In May 2014, TasNetworks submitted its proposed pricing methodology for the 2015–19 regulatory control period. We assessed TasNetworks' proposal as largely the same as the pricing methodology we approved for the 2009–14 regulatory control period, with the exception of the introduction of standby service arrangements for network customers.

Standby service arrangements allow network customers to contract to an agreed maximum demand under normal operating conditions and a greater demand on a standby basis. If approved, it would allow some network customers to increase their load above the contracted agreed maximum demand in their connection agreement without incurring a penalty.[7] The availability of this procedure would be subject to the discretion of TasNetworks and the operational conditions of the transmission network.[8]

12.3 AER's assessment approach

We must approve a proposed pricing methodology if satisfied that it:

- gives effect to, and complies with, the pricing principles for prescribed transmission services

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1 NER, clause 6A.2.2(4).
2 AEMC, *Rule determination: National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No. 22*, 21 December 2006, p. 1.
3 NER, 6A.24.1(b).
4 NER, clause 6A.24.1(b)(1).
5 NER, clause 6A.24.1(b)(2).
6 NER, clause 6A.24.1(c).
7 TasNetworks, *Proposed pricing methodology for 1 July 2015 to 30 June 2019*, May 2014, p. 20.
8 TasNetworks, *Proposed pricing methodology for 1 July 2015 to 30 June 2019*, May 2014, p. 20.

- complies with the information requirements of the pricing methodology guidelines.

TasNetworks' proposed pricing methodology is largely the same as its existing methodology. Our assessment therefore focused on the changes TasNetworks' proposed to introduce in 2015–19 (standby service arrangements). We also considered stakeholder submissions which raised concerns about cost reflectivity of network charges under the proposed pricing methodology.

12.4 Reasons for draft decision

Our draft decision is to approve TasNetworks' proposed pricing methodology. We concluded that the proposed introduction of standby service arrangements—the only material change TasNetworks sought to introduce from the 2009–14 regulatory control period—should lead to better pricing outcomes for customers and is therefore consistent with the NER pricing principles.

We received submissions from stakeholders questioning how cost reflective transmission network charges would be under TasNetworks proposed pricing methodology. We reviewed those submissions but neither those submissions nor our assessment of TasNetworks' proposal identified an aspect of the methodology which was not compliant with the NER pricing principles or the information requirements in the pricing methodology guidelines. We therefore approve TasNetworks' proposed pricing methodology.[9]

12.4.1 Standby service arrangements

We approve the introduction of standby service arrangements. In making our draft decision, the AER examined the proposed arrangements against the pricing principles in the NER. In particular, our assessment was based on clause 6A.23.4 which sets out high level 'price structure principles'.

TasNetworks' proposed standby service would provide network customers with the opportunity to include in their connection agreement:

- the contract agreed maximum demand required under normal operating conditions; and
- a greater demand that may be sought on a standby basis subject to the operational condition of the transmission network.[10]

We consider the availability of standby services would lead to better pricing outcomes for customers. Normally when a customer exceeds its contract agreed maximum demand, it would be liable to pay a penalty known as an 'excess demand charge'. By contrast, the availability of a standby service, allows a customer to avoid that penalty and instead pay charges based on normal operating conditions, plus the incremental cost of providing the greater demand during the standby service.

TasNetworks identified a customer with an onsite generator as a potential beneficiary of a standby service.[11] If, for example, the customer's generator is not available due to scheduled maintenance, then it could notify TasNetworks in advance and request a standby service for a specified period of time. This would allow the customer to increase its demand above the level it has contracted, without incurring a penalty. In comparison, if a standby service is unavailable then the customer would pay an 'excess demand charge' if it increased its load above its contracted amount to cover the outage of its generator.

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9 NER, clause 6A.24.1(c).
10 TasNetworks, *Proposed pricing methodology for 1 July 2015 to 30 June 2019*, May 2014, p. 20.
11 TasNetworks, *Proposed pricing methodology for 1 July 2015 to 30 June 2019*, May 2014, p. 19.

In light of this, we accept that the availability of standby services should lead to better pricing outcomes. We therefore consider the proposed introduction of the arrangements are consistent with the NER pricing principles which are intended to provide transmission businesses with the scope to implement innovative pricing arrangements.[12] This is the position we have previously taken when standby services have been proposed.[13]

12.4.2 Pricing of non-locational TUoS and common transmission services

Some submissions raised concerns about the proposed pricing methodology arrangements.[14]

The Major Energy Users' (MEU) in its submission noted that the proposed pricing methodology is substantially the same as the arrangements the AER approved for TasNetworks' 2009–14 regulatory control period.[15] It was critical of the proposal to maintain those arrangements because based on its own analysis, TasNetworks' historical transmission prices have been volatile and could be altered to be more cost reflective.[16]

The MEU submitted that certain changes were necessary. In particular, that TasNetworks' proposal should be revised so that for non-locational transmission use of system (TUoS) and common transmission services, the price is not set according to the lowest charge resulting from *either* contract agreed maximum demand or energy. The MEU stated that this pricing structure has historically advantaged customers with a poor—and discriminated against those with a good—load factor.[17] Norske Skog provided a similar submission to the AER.[18]

To address its concerns, the MEU stated that TasNetworks should be required to adopt TransGrid's proposed pricing structure for non-locational TUoS and common transmission service. For these services, TransGrid proposed to calculate prices *only* using a customer's contract agreed maximum demand. We note that TransGrid's proposal also involved the application of a side constraint.

We have considered stakeholders' concerns. We accept that prices based on contract agreed maximum demand are more likely to be cost reflective than energy based prices. This is because 'demand' typically drives investment in a transmission network, as opposed to 'energy'.

However, the key NER requirement for the pricing of the non-locational component of TUoS and common transmission services is that it must be subject to a postage stamp structure. The pricing methodology guidelines clarify what this means by specifying structures that we accept as consistent with the 'postage stamp' requirement. The structure that TasNetworks included in its proposed pricing methodology is one of those accepted by us in the pricing methodology guidelines.

Therefore, for non-locational TUoS and common transmission services TasNetworks has proposed to apply a permissible pricing structure and we are satisfied that this meets the postage stamp requirement.

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12 AEMC, *Rule Determination: National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No 22*, 21 December 2006, pp. 27–8.

13 AER, *Draft decision on TasNetworks' 2013–18 regulatory control period*, November 2012, p. 255.

14 MEU, *Submission to the AER*, August 2014; EUAA, *Submission to the AER*, August 2014; Norske Skog, *Submission to the AER*, August 2014; Bell Bay Aluminium, *Submission to the AER*, August 2014.

15 MEU, *Submission to the AER*, August 2014, p. 76.

16

17 MEU, *Submission to the AER*, August 2014, p. 74.

18 Norske Skog, *Submission to the AER*, August 2014, p. 10.

12.4.3 Overall assessment against the pricing principles

We consider TasNetworks' proposed pricing methodology meets the requirements of the NER pricing principles. The pricing principles are intended to provide scope for transmission businesses to develop pricing arrangements that address the circumstances in which they operate their network.[19]

Calculation and allocation of the aggregate annual revenue requirement

We assessed TasNetworks' method for calculating and allocating its aggregate annual revenue requirement, and consider that it meets the NER requirements.

The aggregate annual revenue requirement is the 'maximum allowed revenue' adjusted:

- in accordance with clause 6A.3.2 of the NER, for a number of factors such as cost pass throughs, service target performance incentive scheme outcomes and contingent projects
- by subtracting the operating and maintenance costs expected to be incurred in the provision of prescribed common transmission services

Table 14.1 summarises our review of how TasNetworks' proposed pricing methodology calculates and allocates the business's aggregate annual revenue requirement.

Table 12.1 TasNetworks' proposed calculation and allocation of the AARR against the NER requirements

NER requirements	Assessment
Requirement for the AARR to be calculated as defined in the NER—clause 6A.22.1	Section 6.3 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for the AARR to be allocated to each category of prescribed transmission services in accordance with attributable cost share for each such category of service—clause 6A.23.2(a)	Section 6.3 and Appendix B of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for every portion of the AARR to be allocated and for the same portion of AARR not to be allocated more than once—clause 6A.23.2(c)	Section 6.3 and Appendix B of TasNetworks' proposed pricing methodology satisfies this requirement.
Subject to clause 11.6.11 of the NER, requirement for adjusting attributable cost share and priority ordering approach to asset costs that would otherwise be attributed to the provision of more than one category of prescribed transmission services—clause 6A.23.2(d)	Section 6.3 and Appendix B of TasNetworks' proposed pricing methodology satisfies this requirement.

Allocation of the ASRR to transmission network connection points

We assessed TasNetworks' proposed pricing methodology for allocating the ASRR, and consider it meets the NER requirements. Table 12.2 summarises our assessment.

[19] AEMC, *Rule Determination: National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No 22*, 21 December 2006, pp. 27–8.

Table 12.2 TasNetworks' proposed allocation of the ASRR against the NER requirements

NER requirements	AER assessment
Requirement for whole ASRR for prescribed entry services to be allocated to transmission network connection points in accordance with the attributable connection point cost share for prescribed entry services that are provided by the TNSP at that connection point—clause 6A.23.3(a)	Section 6.9.1 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for the whole ASRR prescribed exit services to be allocated to transmission network connection points in accordance with the attributable connection point cost share for prescribed exit services that are provided by the TNSP at that connection point—clause 6A.23.3(b)	Section 6.9.2 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for the allocation of the ASRR for: prescribed TUOS services locational components pre-adjusted non-locational components —clause 6A.23.3(c)	Section 6.9.3 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for adjusting attributable cost share and priority ordering approach to asset costs that would otherwise be attributed to the provision of more than one category of prescribed transmission services—clause 6A.23.2(d)	Appendix D of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for the recovery of the ASRR for prescribed common transmission services and the operating and maintenance costs incurred in the provision of those services to be recovered through prices charged to transmission customers and network service and network service provider transmission connection points set in accordance with price structure principles set out in clause 6A.23.4—clause 6A.23.3(f)	Section 6.11.4 of TasNetworks' proposed pricing methodology satisfies this requirement.

Development of price structure

We assessed TasNetworks' proposed pricing methodology and process for developing different prices for recovering the ASRR, and consider it meets the NER requirements. Table 12.3 sets out the assessment.

Table 12.3 TasNetworks' proposed pricing structure against the NER requirements

NER requirements	AER assessment
Requirement for separate prices for each category of prescribed transmission services—clause 6A.23.4(b)	Section 6.11 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for fixed annual amount prices for prescribed	Section 6.11.1 of TasNetworks' proposed pricing methodology

NER requirements	AER assessment
entry services and prescribed exit services—clause 6A.23.4(c)	satisfies this requirement.
Requirement for postage stamped prices for prescribed common transmission services—clause 6A.23.4(d)	Section 6.11.4 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for prices for locational component of prescribed TUOS services to be based on demand at times of greatest use of the transmission network and for which network investment is most likely to be contemplated—clause 6A.23.4(e)	Section 6.11.2 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for prices for the locational component of ASRR for prescribed TUOS services not to change by more than 2 per cent per year compared with the load weighted average prices for this component for the relevant region—clause 6A.23.4 to clause 6A.23.4(f)	Section 6.11.2 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for prices for the adjusted non-locational component of prescribed TUOS services to be on a postage stamp basis—clause 6A.23.4(j)	Section 6.11.3 of TasNetworks' proposed pricing methodology satisfies this requirement.

12.4.4 Information requirements

We are satisfied that TasNetworks' proposed pricing methodology complies with the information requirements of the pricing methodology guidelines. Key features of the proposal include:

- acknowledging that TasNetworks is the only transmission business in its region (Tasmania)
- calculating the locational component of prescribed TUOS services costs using a cost reflective network pricing methodology
- basing the locational prescribed TUOS services price on an agreed nominated demand and the average half hourly demand
- basing the postage stamp pricing structure for the non-locational component of prescribed TUOS services and prescribed common transmission services on contract agreed maximum demand or historical energy
- using the priority ordering approach under clause 6A.23.3(d) of the NER to implement priority ordering
- describing how asset costs that may be attributable to both prescribed entry services and prescribed exit services will be allocated at a connection point
- describing billing arrangements as in clause 6A.27 of the NER
- describing prudential requirements as in clause 6A.28 of the NER
- including hypothetical examples

- describing how TasNetworks intends to monitor and develop records of its compliance with its approved pricing methodology.