



FINAL DECISION
Ausgrid distribution
determination
2015–16 to 2018–19

Attachment 19 – Pricing
methodology

April 2015

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Note

This attachment forms part of the AER's final decision on Ausgrid's revenue proposal 2015–19. It should be read with other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 - Annual revenue requirement

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 - Demand management incentive scheme

Attachment 13 - Classification of services

Attachment 14 - Control mechanism

Attachment 15 - Pass through events

Attachment 16 - Alternative control services

Attachment 17 - Negotiated services framework and criteria

Attachment 18 - Connection methodology

Attachment 19 - Pricing methodology

Attachment 20 - Analysis of financial viability

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Shortened forms

| Shortened form | Extended form |
|----------------------------------|--|
| AEMC | Australian Energy Market Commission |
| AEMO | Australian Energy Market Operator |
| AER | Australian Energy Regulator |
| augex | augmentation expenditure |
| capex | capital expenditure |
| CCP | Consumer Challenge Panel |
| CESS | capital expenditure sharing scheme |
| CPI | consumer price index |
| DRP | debt risk premium |
| DMIA | demand management innovation allowance |
| DMIS | demand management incentive scheme |
| distributor | distribution network service provider |
| DUoS | distribution use of system |
| EBSS | efficiency benefit sharing scheme |
| ERP | equity risk premium |
| Expenditure Assessment Guideline | expenditure forecast assessment Guideline for electricity distribution |
| F&A | framework and approach |
| MRP | market risk premium |
| NEL | national electricity law |
| NEM | national electricity market |
| NEO | national electricity objective |
| NER | national electricity rules |
| NSP | network service provider |
| 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 |

| Shortened form | Extended form |
|----------------|---|
| RIN | regulatory information notice |
| RPP | revenue and pricing principles |
| SAIDI | system average interruption duration index |
| SAIFI | system average interruption frequency index |
| SLCAPM | Sharpe-Lintner capital asset pricing model |
| STPIS | service target performance incentive scheme |
| WACC | weighted average cost of capital |

19 Pricing methodology

A transmission pricing methodology forms part of our regulatory determination.¹ Its role is to answer the question 'who should pay how much'² in order for a network business to recover its costs relating to transmission services. 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 network business provides and to the connection points of network users⁴
- determines the structure of prices that a network business may charge for each category of prescribed transmission services.⁵

Ausgrid must submit a transmission pricing methodology to us for approval because its network also comprises some high voltage assets, which are subject to the pricing arrangements for transmission standard control services.⁶

This attachment sets out the determination on Ausgrid's revised pricing methodology for the 2015–19 regulatory control period.

19.1 Final decision

Our final decision is to approve Ausgrid's revised pricing methodology for the 2015–19 regulatory control period. We did not accept its initial proposal so that Ausgrid could engage with TransGrid to ensure that its pricing methodology is inter-linked or consistent with that of TransGrid, which is the co-ordinating transmission network service provider for NSW.⁷ This was necessary since we amended TransGrid's proposed methodology in our draft TransGrid decision. Ausgrid has undertaken that engagement with TransGrid and appropriate amendments have been made, and therefore we approve its revised pricing methodology.

19.2 Ausgrid's revised proposal

Ausgrid submitted its revised pricing methodology for the 2015–19 regulatory control period in January 2015. With the exception of some minor changes, Ausgrid's revised pricing methodology is the same as its initial proposal, submitted to us in May 2014. It is also similar to the pricing methodology we approved for Ausgrid's 2009–14

¹ NER, cl. 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, cl. 6A.24.1(b).

⁴ NER, cl. 6A.24.1(b)(1).

⁵ NER, cl. 6A.24.1(b)(2).

⁶ Ausgrid, *Proposed transmission pricing methodology (Attachment 9.03)*, May 2014, p. 7.

⁷ AER, *Draft decision: Ausgrid distribution determination 2014–15 and 2015–19*, November 2014, p. 19–9.

regulatory control period. Importantly, however, Ausgrid has made some changes to its methodology to reference TransGrid's revised pricing approach, where relevant.

In NSW, TransGrid is the co-ordinating transmission network service provider. Ausgrid is one of a number of 'appointing providers' in the region. In these circumstances, TransGrid is responsible for performing some transmission pricing functions on Ausgrid's behalf. These functions include:

- any adjustments required to be made to the locational component of the annual service revenue requirement (ASRR) as required in the NER
- any adjustments required to be made to the pre-adjusted non-locational component of the ASRR as required in the NER.
- allocation of the locational component of prescribed TUoS services to transmission connection points
- establishing the structure and price for prescribed transmission services.⁸

Since these functions are performed by TransGrid, they are not addressed in Ausgrid's pricing methodology; however, the methodology needs to make reference to relevant aspects of TransGrid's methodology. Ausgrid's revised proposal now states when TransGrid's pricing methodology should be referred to, in order to determine how its services will be priced. In that way, Ausgrid's revised pricing methodology is interlinked with the pricing arrangements which have been approved for TransGrid.

19.3 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
- complies with the requirements of the pricing methodology guidelines.⁹

19.4 Reasons for final decision

We approve Ausgrid's proposed pricing methodology. It gives effect to the pricing principles for prescribed transmission services and complies with the requirements in the pricing methodology guidelines.

Our draft decision required Ausgrid to engage with TransGrid about their respective pricing methodologies. This is given we did not accept aspects of the latter's proposed methodology to which Ausgrid's was interlinked. Ausgrid has consulted with TransGrid about the latter's revised pricing methodology. We have also assessed TransGrid's revised pricing methodology submitted in January 2015. Our final decision is to approve TransGrid's revised pricing methodology and hence it follows that we approve

⁸ Ausgrid, *Revised transmission pricing methodology (Attachment 9.03)*, January 2015, p. 5.

⁹ NER, cl. 6A.24.1(c).

Ausgrid's too. Our reasons are set in attachment 19 of our final decision on TransGrid's revised pricing methodology: <http://www.aer.gov.au/node/23137>.

It is important to clarify how Ausgrid's and TransGrid's pricing methodologies will interact. We note that the lengths of the two businesses' regulatory control periods are different. Ausgrid's is from 1 July 2015 to 30 June 2019. TransGrid's regulatory control period has the same commencement date but ends on 30 June 2018.

In this context, the NER require that Ausgrid's approved pricing methodology must apply, and cannot be amended, for the duration of its 2015–19 regulatory control period.¹⁰ In our draft decision, we noted that if TransGrid submits a modified pricing methodology for its next regulatory control period (2018–19 and beyond), those modifications will not apply to Ausgrid in 2018–19.¹¹ We no longer consider this to be the case.

Any modifications to TransGrid's pricing methodology in 2018–19 will, as a matter of course, apply to Ausgrid. We now consider that this outcome is consistent with the NER because Ausgrid is applying the same methodology throughout the 2015–19 regulatory control period, that is, it is adopting the pricing arrangements TransGrid has in operation.

19.4.1 Assessment against the pricing principles

We consider Ausgrid's revised pricing methodology accords with 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.¹²

19.4.1.1 Calculation and allocation of the aggregate annual revenue requirement

We assessed Ausgrid's 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

¹⁰ NER, cl. 6A.24.1(e) and (f).

¹¹ AER, *Draft decision: Ausgrid distribution determination 2014–15 and 2015–19*, November 2014, p. 19–8.

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

Table 19.1 summarises our review of how Ausgrid' proposed pricing methodology calculates and allocates the business's aggregate annual revenue requirement.

Table 19.1 Ausgrid's 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 3.1 of Ausgrid's proposed pricing methodology complies with 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 3.3 of Ausgrid's proposed pricing methodology complies with 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 3.2 and Appendix A of Ausgrid's proposed pricing methodology complies with 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 3.2 and Appendix A of Ausgrid's proposed pricing methodology complies with this requirement. |

Source: Ausgrid, *Revised transmission pricing methodology (Attachment 9.02)*, January 2015.

19.4.1.2 Allocation of the ASRR to transmission network connection points

We assessed Ausgrid's proposed pricing methodology for allocating the ASRR, and consider it meets the NER requirements. The exception to this is the requirement to allocate the annual service revenue requirement (ASRR) to prescribed TUoS services. Table 19.2 summarises our assessment.

Table 19.2 Ausgrid's 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 3.4.1 of Ausgrid's proposed pricing methodology complies with 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 3.4.2 of Ausgrid's proposed pricing methodology complies with this requirement. |
| Requirement for the allocation of the ASRR for: prescribed TUoS services locational components | The allocation of the locational component of prescribed TUoS services will be carried out by TransGrid on the behalf of Ausgrid. |

| NER requirements | AER assessment |
|---|--|
| pre-adjusted non-locational components —clause 6A.23.3(c) | |
| 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 3.4.4 and Appendix A of Ausgrid's proposed pricing methodology complies with 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) | Appendix A of Ausgrid's proposed pricing methodology complies with this requirement. |

Source: Ausgrid, *Revised transmission pricing methodology (Attachment 9.02)*, January 2015.

19.4.1.3 Development of price structure

A pricing methodology must develop a price structure which complies with the NER.¹³ However, Ausgrid's proposal did not set out how it will develop a price structure. It stated that TransGrid is responsible for undertaking this on its behalf for locational charges, TUoS general charges and common service charges.¹⁴ We are satisfied that it is appropriate for TransGrid as the co-coordinating network service provider in NSW, to develop the price structure for Ausgrid's prescribed transmission services.

19.4.2 Information requirements

The AER is satisfied that the revised pricing methodology complies with the information requirements of the pricing methodology guidelines. Key features of the proposal include:

- acknowledging that there are multiple transmission business in its region (New South Wales) including TransGrid, Directlink, Ausgrid, and ActewAGL
- using the priority ordering approach under clause 6A.23.2(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

¹³ NER, cl. 6A.23.4.

¹⁴ Ausgrid, *Revised transmission pricing methodology (Attachment 9.02)*, January 2015, p. 10.

- including hypothetical examples
- describing how Ausgrid intends to monitor and develop records of its compliance with its approved pricing methodology.