



FINAL DECISION
Powerlink transmission
determination
2017–22

Attachment 12 – Pricing
methodology

April 2017

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Note

This attachment forms part of the AER's final decision on Powerlink's transmission determination for 2017–22. It should be read with all other parts of the final decision.

This final decision consists of an Overview and 11 attachments. As many issues were settled at the draft decision stage or required only minor updates we have not prepared final decision attachments for:

- Regulatory depreciation
- Operating expenditure; and
- Corporate income tax.

The AER's final decision on these matters is set out in the Overview. For ease of reference the remaining attachments have been numbered consistently with the attachment numbering in our draft decision.

The final 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 6 – Capital expenditure

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

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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	annual service revenue requirement
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DMIA	demand management innovation allowance
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
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

Shortened form	Extended form
RPP	revenue and 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

This attachment sets out our final decision on Powerlink's proposed pricing methodology for the 2017–22 regulatory control period.

A pricing methodology must be specified as part of our transmission determination¹ and answers the question 'who should pay how much'² in order for a transmission business to recover its efficient costs. To do this, the National Electricity Rules (NER) set out that it must provide a 'methodology, 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 users⁴
- provides the manner and sequence of adjustments to the annual service revenue requirement⁵ and allocates that requirement to transmission connection points⁶
- determines the structure of prices that a transmission business may charge for each category of prescribed transmission services.⁷

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

12.1 Final decision

Our final decision is to approve Powerlink's revised pricing methodology.

We are satisfied the revisions Powerlink made to setting the locational component of transmission use of system (TUOS) prices for new connections addresses the concerns set out in our draft decision.

We consider the revised pricing methodology gives effect to the pricing principles in the NER and complies with the requirements of the pricing methodology guidelines, as is required by clause 6A.24.1(c).⁸

The approved pricing methodology is set out in attachment B of our final decision.

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 NER, cl. 6A.24.1(b)(3).

⁷ NER, cl. 6A.24.1(b)(4).

⁸ NER, cl. 6A.14.1(8).

12.2 Powerlink's revised proposal

Powerlink considered that we had misinterpreted or misunderstood the proposed amendments to the setting of TUOS locational prices in our draft decision.⁹ However, in its revised proposal, Powerlink made editorial changes to the pricing methodology to clarify the intent of the proposed amendments. Specifically, it revised section 6.12 to clarify that a side constraint would not apply to an interim locational TUOS price where a previously calculated and published TUOS locational price does not exist.¹⁰

12.3 Assessment approach

A proposed pricing methodology must:

- give effect to, and comply with, the pricing principles for prescribed transmission services
- comply with the requirements of, and contain or is accompanied by information required by, the pricing methodology guidelines.¹¹

Our assessment approach was guided by these requirements. In particular, we assessed whether the editorials Powerlink made to its description of how it will set its locational TUOS prices give effect to the requirements in the NER.

12.4 Reasons for final decision

Our draft decision accepted all but one aspect of Powerlink's initial proposed pricing methodology.¹² Our concern was that Powerlink's proposed amendments to set an interim TUOS locational price did not comply with clause 6A.23.4(b)(2) of the NER, which requires prices to be subject to an annual side constraint of 2 percent. That is, locational TUOS prices in the forthcoming year must not change by more than 2 per cent relative to the price set for the previous year.

In response to our draft decision, Powerlink stated that the AER had either misinterpreted or misunderstood the nature of the proposed amendments.¹³ Powerlink explained that the interim price not subject to the 2 per cent side constraint would only apply to a new connection point 'without a previously calculated TUOS locational price'. In this situation, the customer does not have a previous price for which the 2 per cent side constraint in clause 6A.23.4(b)(2) of the NER may apply. However, the side constraint would apply to an existing connection with a previously calculated TUOS

⁹ Powerlink, *Revised regulatory proposal*, December 2016, pp. 20–21.

¹⁰ Powerlink, *Revised regulatory proposal*, December 2016, p. 21.

¹¹ NER, cl. 6A.24.1(c).

¹² AER, *Draft decision: Powerlink transmission determination 2017–18 to 2021–22: Attachment 12 – Pricing methodology*, September 2016.

¹³ Powerlink, *Revised regulatory proposal*, December 2016, p. 21.

locational price. To make this point clear in its pricing methodology, Powerlink made editorial changes to the relevant section as follows:¹⁴

In the event that Powerlink is required to set a TUOS locational price at a new connection point **without a previously calculated TUOS locational price**, an interim price not subject to the side constraints of clause 6A.23.4(b)(2) will be determined. At an existing connection point where the load has changed significantly after prescribed TUOS service locational prices have been determined and published an interim price will be calculated subject to clause 6A.23.4(b)(3). This will be calculated using the prevailing pricing models with demands estimated in a manner consistent with clause 2.2(f) of the pricing methodology guidelines.

A price subject to the side constraints of clause 6A.23.4(b)(2) will be determined and published at the next annual price determination.

On the basis of the clarification, we consider Powerlink's revised pricing methodology satisfies the requirements in the NER. The practical outcomes for a new connection point without a previously calculated TUOS locational price means that no side constraint can be applied. We consider Powerlink's editorials in section 6.12 of the revised pricing methodology make this distinction clear.

¹⁴ Powerlink, *Revised regulatory proposal: Appendix 3.03 Revised pricing methodology*, November 2016, p. 17.