Ausgrid

Joseph Pizzinga
Chief Financial Officer

570 George Street
Sydney NSW 2000
All mail to GPO Box 4009
Sydney NSW 2001
F +61 2 9269 2121
T +61 2 9269 4550
www.ausgrid.com.au

4 February 2016

Mr Chris Pattas
General Manager – Network Investment and Pricing
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3000

Dear Mr Pattas

Submission on CitiPower Revised Regulatory Proposal 2016-20

Ausgrid welcomes the opportunity to make a submission on the CitiPower Revised Regulatory Proposal 2016-20. This submission focuses on the application of the pass through framework to alternative control services (ACS).

We note that the AER agreed with CitiPower's proposal (as well as the four other Victorian Distribution Network Service Providers (DNSPs)) that nominated pass through events refer to 'direct control services'. This means that DNSPs may apply to pass through an increase (or decrease) in costs incurred in providing both standard control services (SCS) or ACS. This is consistent with the prescribed pass through event definitions set out in the National Electricity Rules (NER), which also reference direct control services. Ausgrid agrees and supports the AER's decision on this point.

We note that the AER's final decision for the NSW DNSPs 2014-19 determination was silent on whether it accepted Ausgrid's proposal to apply the pass through framework to ACS.[1] For the avoidance of any doubt, Ausgrid considers that the AER should make it clear in all of its future regulatory determinations that the pass through framework applies to ACS. This is important as the risks faced by DNSPs in relation to these services are the same as those faced in providing SCS and the availability of cost pass through provisions is consistent with the basis of the control mechanisms which have been developed in relation to those services.

To that end, we agree with CitiPower[2] that:

> *for the avoidance of doubt, we request that the AER specify this in its final determination in connection with its constituent decision on the form of the control mechanism for alternative control services under clause 6.12.1(12) of the Rules. Alternatively, if the AER considers this unnecessary, we request the AER to expressly confirm that this is because it shares our understanding that the correct legal construction of the Rules is that the Rules in and of itself applies clause 6.6.1 to alternative control services.*

There however remain issues about the ways in which the pass through framework applies to ACS that need clarification and we are quite concerned about the positions that the AER is taking with respect to these issues. Given the increasing importance of ACS to a DNSP's business, it is now imperative the application of the pass through framework to ACS is well defined, robust, workable and achieves the intended objectives of the pass through mechanism. Ausgrid notes that it is open to the AER under the National Electricity Rules (NER) to establish such a framework. It is from this perspective that Ausgrid is raising these issues which are:

---

[1] See Ausgrid's regulatory proposal, 1 July 2014 to 30 June 2019, 30 May 2014, page 29 and Attachment 4.13 to this proposal.

[2] CitiPower Revised Regulatory Proposal 2016–2020, p 413

1. The definition of 'materially' to be applied in determining when assessing a pass through application that relates to ACS.
2. The appropriate mechanism to recover the approved pass through amount as determined by the AER.

Definition of 'materially' for ACS

In its preliminary decision for CitiPower, the AER rejected CitiPower's proposal to use the 'ordinary and natural meaning' of 'materially' instead of the definition of 'materially' in the NER when applying the pass through framework to ACS. This is because the NER definition of 'materially' refers to annual revenue requirement as the reference point in calculating the 1% threshold and the concept of annual revenue requirement is distinct and specific to SCS.

We agree with CitiPower that it would be perverse to assess the materiality of the cost impact of an event that relate solely to ACS by reference to the annual revenue requirement of SCS. On the other hand, we note in rejecting CitiPower's approach, the AER is concerned with the uncertainty such an approach creates.

Whilst we recognise the AER's concerns with CitiPower's proposed approach, we do not consider that it is sufficiently clear from the AER's preliminary decision as to how 'materially' should be defined when applying the pass through framework to ACS. In rejecting CitiPower's proposed definition, the AER stated that:

> *The current definition of 'material' provided by the NER provides clarity and certainty in the operation of the pass through mechanism.*

While this may be true with respect to the application of the pass through framework to SCS as the definition of 'materially' in the NER refers to annual revenue requirement, we are uncertain if the above statement by the AER provides any further clarity on the issue when the pass through framework is applied to ACS. This is, as stated above, the definition of 'materially' in the NER refers specifically to annual revenue requirement as the measurement for the 1% threshold. By seemingly 'adopting' or 'referencing' the NER definition of materiality, the AER risks undermining its decisions on classification of services; and further we are doubtful if such an approach is permissible under the NER.

Ausgrid agrees with CitiPower that it is open for the AER under the regulatory framework to adopt a different definition of 'materiality' in respect of ACS. Ausgrid considers that it would not be inconsistent for the AER to adopt the 'ordinary and natural meaning' of the term 'materiality,'

Whilst we note that the AER has expressed concerns that adopting this approach as it may give rise to uncertainty and frivolous claims, Ausgrid notes that the pass through framework operates merely as a gateway for a network service provider to re-open their determination to have costs that were beyond their control to prevent and/or mitigate, and could not be reasonably forecasted at the time of their determination, considered. The making of a pass through application in itself does not equate to an automatic pass through of costs. The DNSPs must demonstrate to the AER's satisfaction that the positive change event has occurred and only once the AER is satisfied that a positive change event had occurred that the AER needs to approve the amount to be passed through to customers. In this approval process, the NER afforded the AER a number of safeguards to ensure that only the efficient costs incurred by the network service provider are allowed to be passed through to customers.[3] For example the AER can form an assessment of the decisions and actions or failure to take actions by the network service provider to reduce the cost impacts from the event.

The pass through framework therefore has in place appropriate safe guards for ensuring that the proposed pass through amount is subject to the same level of scrutiny as the network service provider's determination. Therefore, we do not consider applying an 'ordinary and natural meaning' of the term 'materiality' exposes customers to a risk of vexatious or frivolous pass through claims, as it does not in any way negate or detract from the obligation on the AER to assess each pass through application on its merits.

[3] See the relevant factors under 6.6.1(j) of the NER.

We however note the AER's desire to achieve certainty and perhaps the definition in the NER is instructive and we consider that a symmetrical definition may also be adopted by the AER when applying the pass through framework to ACS. That is, materiality should operate in the same way for ACS in that it is one percent of the revenue or of the costs required to provide the relevant alternative control service (e.g. type 5-6 metering services or ancillary network services) that is impacted by the event that had occurred. We have referred to either revenue or costs as the reference to measure the 1% threshold to cater for ANS that may not have forecast revenue because the revenue of such services are dependent upon customers' uptake (i.e. volume). In these instances, the costs of providing the services (which presumably serves as the basis of the control mechanism for such services) should be used as the reference to calculate the 1% materiality threshold that determines whether a positive/negative change event has occurred.

We consider either of the above approaches is open to the AER and we see merits in both. We note that in some respects the 'undefined' approach better aligns with the nature of services classified as ACS and avoids the issues that may arise from the fact that the form of control for the relevant ACS service is based on a cost build up rather than revenue forecast. On the other hand, a 'symmetrical definition' removes any unambiguity, provides clarity on the issue and at the same time applies the same concept and framework in the NER that are well accepted to ACS. Either way, we consider the AER needs to clarify its preferred approach to assessing materiality rather than leaving it ambiguous as it currently is in its preliminary decision for CitiPower.

Recovery of approved pass through amount

Under the pass through framework, we note that a pass through application is only a gateway to seeking the AER's approval to recover from customers the proposed (or amended and approved) pass through amount. The AER can either approve or not approve a pass through application and it is only once a pass through application is approved that the issue of how the approved amount is to be recovered needs to be considered.

In its regulatory proposal, CitiPower proposed that any approved pass through amounts for ACS should be recovered via a factor or an element of the control mechanism of ACS. In CitiPower's case, it proposed the formulae giving effect to the control mechanism for ACS include a B factor to account for any approved pass through amount for ACS. The AER rejected this proposal and stated that:

> *As we do not approve a new materiality definition for alternative controls services, we consider the rationale for CitiPower's proposed variation to the control mechanism at least in part falls away. It is unlikely a potential pass through event would meet the materiality definition in the NER if it impacted only CitiPower's costs of providing alternative control services. CitiPower may recover the full amount of an approved pass through via standard control service charges. We consider customers are no worse off under our approach because most, if not all, alternative control service customers are also standard control service customers.*

We do not agree with the AER's above reasons for rejecting CitiPower's proposal to define the B factor in the control mechanism for ACS to cater for any pass through amount approved by the AER. The issue of materiality is relevant for determining whether a positive change event has occurred. Once such event had been determined by the AER to have occurred, the AER then determines the amount to be passed through to customers and how this amount should be recovered. Materiality does not have a role to play in this step and consequently is not a sound basis for rejecting CitiPower's proposal to effect the recovery of the approved pass through amount in the control mechanism of the relevant direct control services. That is, if the positive change event relates to SCS, then the approve pass through amount should be recovered in the control mechanism for SCS and likewise if a positive change event has occurred for ACS, the approved amount should be recovered via the control mechanism for ACS.

Moreover, whilst it may be the case that ACS customers are also SCS customers, this fact is not of itself a sufficient basis to reject CitiPower's proposed approach. Further we note that recovering an increase in ACS costs from SCS customers is inconsistent with the pricing principles as it distorts price signals to customers by not exposing customers to the true cost of providing the service.

We do not believe that CitiPower's approach to encompass the recovery of approved pass through amount for ACS in the control mechanism for ACS would make pricing ACS overly complex. As the AER determines charges separately for individual ACS under a price cap control mechanism the resultant pricing outcomes are known. As such, we do not believe that the AER is correct that there would be additional complexity or disadvantages for customers or other stakeholders by adopting this approach. In fact, we believe the counter argument is true, that is, as some of the ACS services are somewhat 'bespoke' in nature and impact on a smaller customer base, SCS customers should neither bear the risk of cost recovery in the case of a positive change event nor enjoy the benefit from a cost saving in the case of a negative change event.

Once it is accepted that the pass through framework is equally applicable to both SCS and ACS, a clear delineation of the application of this framework to SCS and ACS should be maintained and not 'mixed up' as the AER appears to have done in its preliminary decision for CitiPower. This is important for Ausgrid (and other DNSPs) as there are likely to be future pass through events (positive and negative) associated with the implementation of the AEMC's Expanding Competition and Related Services Rule Change which will impact primarily on ACS. It is equally important that a sound framework for applying the pass through mechanism to ACS is established now given the likelihood of more services becoming classified as alternative control services.

If you would like to discuss our submission further or arrange a meeting with Ausgrid representatives please contact Son Truong Vu on (02) 9269 4360.

Yours sincerely

JOE PIZZINGA
Chief Financial Officer