

Proposed (Draft)

**Transmission pricing
methodology guidelines**

Explanatory Statement

25 July 2007



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1. Introduction

The Australian Energy Regulator (AER) is responsible for regulating the revenues of Transmission Network Service Providers (TNSPs) in the National Electricity Market (NEM) in accordance with the National Electricity Rules (NER).

As part of a revenue determination, a TNSP is required to submit a proposed pricing methodology to the AER for approval. To assist TNSPs in developing their pricing methodologies the AER is required to publish transmission Pricing Methodology Guidelines (the guidelines). The development of the guidelines and the assessment of a TNSP's proposed pricing methodology is a new role for the AER conferred upon it by the NER.

Prior to publishing the final guidelines, the NER requires the AER to develop proposed guidelines. In April 2007 the AER released an issues paper as the first stage in the development of the guidelines. The issues paper sought submissions on those areas that the AER is required to clarify or specify in the guidelines.

This explanatory statement accompanies the proposed guidelines as required by clause 6A.20(b)(2) of the NER. It sets out the NER requirements, the purpose and objectives of the proposed guidelines, the nature and reasons for the proposed guidelines (including consideration of submissions on the issues paper) and the consultation process to be undertaken. It also invites written submissions on the proposed guidelines as required by clause 6A.20(b)(3) of the NER.

The AER engaged Network Advisory Services (NAS) to review the issues paper and submissions made in relation to it and provide advice to the AER on the contents of its proposed guidelines. The NAS report has been published at the same time as the proposed guidelines and explanatory statement and they should be read together. The NAS report is available on the AER's website.¹

2. NER requirements

In accordance with clause 6A.25.1, the AER is required to publish the final guidelines by 31 October 2007. The transmission consultation procedures contained in part H of chapter 6A of the NER outline the process to be followed by the AER in developing the final guidelines. The transmission consultation procedures require the AER to publish proposed guidelines with an explanatory statement and invite written submissions on the proposed guidelines. Within 80 business days of publishing the proposed guideline, the AER must publish the final guidelines.

In accordance with clause 11.8.4, the AER has developed and published agreed interim requirements that apply to the pricing methodologies of ElectraNet, SPAusNet and

¹ See www.aer.gov.au

VENCorp.² The agreed interim requirements were developed for those TNSPs that lodged a proposed pricing methodology prior to the AER publishing its final guidelines. The agreed interim arrangements are not discussed further in this explanatory statement or the proposed guidelines.

Clause 6A.24.1 requires that in making a transmission determination, the AER must include a decision to approve a TNSP's proposed pricing methodology and that proposed pricing methodology must comply with the requirements of, and contain, or be accompanied by, information required by the final guidelines.

Clause 6A.25.1(b) states that the final guidelines must give effect to and be consistent with the pricing principles for prescribed transmission services contained in clause 6A.23 of the NER.

Clause 6A.25.1(b)(1) states that the guidelines may be amended or replaced by the AER from time to time in accordance with the transmission consultation procedures contained in chapter 6A of the NER.

3. Structure of this document

This document is structured as follows:

- Section 4 sets out the purpose and objectives of the proposed guidelines.
- Section 5 outlines the nature and reasons for the proposed guidelines. For each area the AER must specify or clarify, it sets out the relevant rule requirements, what was discussed in the AER's issue paper, issues raised in submissions, NAS findings and the AER's considerations and conclusions.
- Section 6 describes the consultation process that the AER will undertake in developing the final guidelines.
- Section 7 invites written submissions on the proposed guidelines.

4. Purpose and objectives of the proposed guidelines

The purpose of the proposed guidelines is to assist TNSPs in developing their proposed pricing methodologies by specifying or clarifying the information requirements, pricing structures, asset allocation and confidential elements of a TNSP's proposed pricing methodology. The objectives of the proposed guidelines are to:

- contribute to the NEM objective

² The agreed interim arrangements for ElectraNet, SPAusNet and VENCorp are available on the AER website, see www.aer.gov.au.

- provide guidance to TNSPs when preparing proposed pricing methodologies which must be consistent with the pricing principles for prescribed transmission services in the NER.

The proposed guidelines must be read in conjunction with the relevant provisions of chapter 6A of the NER.

5. The nature and reasons for the proposed guidelines

The revenue cap form of regulation allows a TNSP to earn up to a maximum allowed revenue (MAR) within a regulatory year. The MAR is used to derive the aggregate annual revenue requirement (AARR) which is allocated to categories of prescribed transmission services.

Transmission prices must be determined in accordance with the pricing principles contained in the NER and the proposed guidelines supplement and elaborate on the pricing principles in so far as they specify or clarify:

- the information that is to accompany a TNSP's proposed pricing methodology
- pricing structures for the recovery of prescribed transmission use of system services and prescribed common transmission services
- the types of assets that are directly attributable to each category of prescribed transmission service
- the parts of a proposed pricing methodology, or the information accompanying it which will not be publicly disclosed without the consent of the TNSP.

In April 2007, the AER released an issues paper as the first step in the development of the final guidelines. The AER has prepared its proposed guidelines taking into account the submissions received on the issues paper. The AER will develop the final guidelines taking into account submissions received in response to the proposed guidelines. In addition the AER may revise the guidelines in the future as it gains further experience in assessing TNSP's pricing methodologies.

In its rule determination, the AEMC outlined its rationale underpinning the pricing principles in the new pricing rule including its reasons for specifying that location prices be based on demand and that postage stamp pricing structures be used to calculate non locational TUOS and common service charges.³ The AEMC considered that prices intended to send locational investment and network usage signals should be based on a transmission customer's demand at times of peak system demand as it is network loading during peak system conditions that drives transmission investment. The AEMC also considered that postage stamping structures should be retained, however the details surrounding them should be determined by the AER.

³ The AEMC's Rule Determination is available on its website, see www.aemc.gov.au.

5.1 Submissions on the issues paper

The AER's issues paper released in April 2007 provided an overview of the new pricing rules contained in part J of chapter 6A of the NER as a precursor to discussion of the relevant issues the AER must address in its pricing methodology guidelines. The issues paper identified a number of questions on which comments from interested parties were specifically sought. Interested parties were also encouraged to provide comments on other relevant issues not discussed in the paper. The AER received submissions from the following interested parties:

- Major Energy Users (MEU)
- EnergyAustralia
- VENCORP
- Electricity Transmission Network Owners Forum (ETNOF)
- National Generators Forum (NGF).

Submissions can be found on the AER's website.

5.2 Information requirements

5.2.1 AER issues paper

In accordance with clause 6A.25.2(a) of the NER, the final guidelines must specify or clarify the information to be provided by a TNSP in its proposed pricing methodology. The information provided should be sufficient to allow the AER to form a view that the proposed pricing methodology is consistent with and gives effect to the pricing principles (outlined in clause 6A.23) and the requirements of part J of the NER. In its issues paper the AER stated that it had not formed a view about the information it would request from TNSPs, however, it included a list of possible information requirements.

5.2.2 Issues raised in submissions

ETNOF considered that the list of information in the issues paper was sufficient. However it was concerned that the list of issues would imply that much greater scope and detail should be provided than previously required. Further, in relation to a number of the items in the issues paper, ETNOF indicated that all a proposed pricing methodology would do is simply restate clauses in the NER.

EnergyAustralia stated that the AER had not considered the situation where transmission prices for networks in a jurisdiction are calculated by a co-ordinating network service provider within a region.

The MEU considered that the final guideline should be prescriptive in respect of how information must be prepared in order to promote consistency amongst TNSPs.

VENCorp stated that the final guidelines should recognise any jurisdictional derogation which may affect a TNSP's proposed pricing methodology. VENCORP also stated that in making guidelines, the AER does not have the power to require TNSPs to provide information for the purpose of facilitating the AER's monitoring and enforcement of a proposed pricing methodology.

5.2.3 NAS findings

NAS considered that the AER should address the requirements of the NER in relation to the information requirements of a TNSP's proposed pricing methodology having particular regard to the benefits of transparency and the AER's monitoring, reporting and enforcing role.

NAS stated that the information included in a TNSP's proposed pricing methodology should be sufficiently detailed and relevant to enable the AER to form a view about whether it gives effect to and is consistent with the pricing principles and the requirements of part J of the NER. Further, the information provided should assist users in understanding how prices are used to calculate charges. NAS considered the inclusion of hypothetical worked examples would enhance transparency and assist users' understanding of prescribed transmission service prices and charges.

5.2.4 AER considerations

In response to ETNOF's concerns that the list of issues would imply greater scope and detail than previously required, the AER notes that clause 6A.25.2(a) of the NER indicates that the guidelines must specify sufficient information which allows the AER to form a view that a TNSP's proposed pricing methodology is consistent with and gives effect to the pricing principles and the requirements of part J of the NER. In the proposed guidelines the AER has outlined the information it considers necessary to enable it to determine this.

The AER notes EnergyAustralia's comments in relation to co-ordinating network service providers. A co-ordinating network service provider must be appointed, by appointing providers, in a region where prescribed transmission services are provided by more than one TNSP.⁴ Further clause 6A.29.1(d) of the NER states that a co-ordinating network service provider is responsible for the allocation of all relevant aggregate annual revenue requirement (AARR) within a region and that an appointing provider is not required to address the matters specified in clause 6A.24.1(c)(1) when preparing its proposed pricing methodology. The proposed guidelines now accommodate these issues.

The proposed guidelines also acknowledge jurisdictional derogations and the transitional arrangements under chapter 11 of the NER and request that proposed pricing methodologies provide information on each, should they apply.

⁴ Appointing providers are those TNSPs who appoint a co-ordinating network service provider for a region.

The AER has requested details of how a TNSP will maintain records of the application of its approved pricing methodology and how it will monitor compliance with its approved pricing methodology. Clause 6A.17.1 of the NER provides for information to be provided by the TNSP to the AER which the AER may use to monitor, report on and enforce compliance with a transmission determination. A pricing methodology is a component of a transmission determination.

In the proposed guidelines, the AER has requested TNSPs to provide hypothetical worked examples showing how the attributable cost share, attributable connection point cost share and priority ordering process will be undertaken. The AER considers the inclusion of worked examples will assist it in reviewing the proposed pricing methodology to determine whether it complies with the pricing principles. The use of hypothetical examples prevents specific details about a particular user being disclosed when the proposed pricing methodology is published by the AER in accordance with 6A.11.3(a)(3) of the NER.

5.2.5 AER conclusion

Taking into account submissions and the recommendations contained in the NAS report, the AER considers that the information requested in section 2.1 of the proposed guidelines will allow it to form a view as to whether the TNSP's proposed pricing methodology is consistent with, and gives effect to the pricing principles for prescribed transmission services and the requirements of part J of the NER.

5.3 Permitted pricing structures (locational)

5.3.1 AER issues paper

In accordance with clause 6A.25.2(b) of the NER the proposed guidelines must specify or clarify permitted pricing structures for the recovery of the locational component of prescribed TUOS services. In doing so, the AER must consider the desirability of a consistent approach across the NEM and the role of pricing structures in signalling efficient investment and network utilisation decisions. The issues paper provided several options for interested parties to consider and comment on. Parties were also encouraged to suggest alternative demand based structures which were consistent with the pricing principles in the NER.

5.3.2 Issues raised in submissions

EnergyAustralia stated that the final guidelines should not exhaustively state permitted pricing structures and that there is little benefit in prescribing complex pricing structures at connection points as distribution network service providers (DNSPs) are unable to act on any signals those structures provide. In response to a question in the issues paper on the use of kilovoltamperes (kVA) rather than kilowatts (kW) in pricing structures, EnergyAustralia highlighted that the use of kVA would result in additional metering costs for TNSPs currently without kVA metering. EnergyAustralia also stated a preference for a pricing structure based on the highest consumption in peak periods occurring during the previous 12 months.

ETNOF supported a move to a consistent approach for TUOS locational prices, however, it stated that it may be desirable to phase in changes over a number of years to avoid price shocks. It also stated that transmission charges are a small component of overall costs for most loads and therefore there was little point in providing a highly sophisticated price signal. ETNOF stated a preference for an easily identified price signal which is simple to calculate and suggested a demand based price with penalties for exceeding the nominated maximum demand would be appropriate. Due to a lack of revenue quality metering, ETNOF considered that a phase in of the use of kVA pricing would be required. ETNOF also considered that a demand based price could include an energy or fixed price.

The MEU considered that transmission networks are constructed to deliver the contracted demand and therefore contracted demand or the highest demand recorded in the previous 12 months should be the basis for locational pricing. Further the MEU considered that T-price⁵ be used to allocate costs to connection points between the hours of 11:00 and 19:00 on the 10 highest system demand days in the previous 12 months. MEU stated that it was questionable whether the use of megavoltamperes (MVA) would add significant value to the transmission network.

VENCorp considered that a consistent approach to prescribed TUOS locational pricing was desirable as it will enable network users to make like for like comparisons of transmission costs across the NEM. It did not anticipate complex and widespread step changes for the locational component of prescribed TUOS services. VENCORP expressed a preference for option four in the issues paper utilising forecast maximum demand at peak system times rather than historical maximum demand. VENCORP considered that locational pricing does not have the ability to signal efficient network investment decisions. It stated that transmission network augmentations are determined separately via the regulatory test assessment and are not influenced by transmission pricing. VENCORP also considered that transmission charges represent a small proportion of overall costs for new loads and therefore have little impact on users' location decisions.

5.3.3 NAS findings

NAS noted that the AER must consider the desirability of consistency of pricing structures across the NEM, however, that did not mean that structures need be identical. It also considered that the AER also needed to consider the role of stability in minimising price shocks. NAS recommended that the AER specify permitted pricing structures in order to promote consistency but allow a TNSP to propose an alternative pricing structure provided it gave effect to and was consistent with the pricing principles in the NER.

NAS stated that the AEMC's intention was that locational prices were to be based on demand at times of greatest utilisation of the transmission network and that they should not be based on consumption. It noted the AEMC's intention that prices provide effective signals to users. NAS stated that in order to provide effective signals, demand

⁵ A software package used by TNSPs to determine cost reflective network pricing (CRNP) and modified CRNP.

based prices should allow users to know in advance what circumstances will affect their charges.

To accommodate the general principles outlined above, NAS recommended two pricing structures. The first provides for the use of the higher of agreed contracted maximum demand and the actual maximum demand in the previous 12 months. The second is based on the average of the 10 highest maximum demand days at a connection point in the previous 12 months.

5.3.4 AER considerations

The AER notes the comments made by EnergyAustralia and ETNOF in support of a simple pricing structure. It also notes the comments of EnergyAustralia with respect to not limiting pricing structures.

The AER's overall assessment is that the permitted pricing structures provided in the proposed guidelines are not complex and should not be difficult to calculate and apply. In addition, the proposed guidelines permit TNSPs to propose alternative pricing structures which give effect to and are consistent with the pricing principles in the NER. The onus is therefore on the TNSP to demonstrate to the AER that any proposed alternative pricing structure is consistent with the NER and the NEM objective.

Submissions on the issues paper indicate a lack of support for mandating the measurement of demand on a kVA basis as opposed to a kW basis largely due to the absence of suitable metering in all jurisdictions of the NEM. The AER, however, does not rule out mandating the use of kVA at some later stage, as more suitable kVA metering becomes available.

The AER notes that the AEMC stated in its pricing determination that the locational TUOS charge should be based on demand and not consumption.⁶ The AER considers that demand is a measure of instantaneous electricity delivery measured in kW or kVA and that energy consumption measured in kilowatthours (kWh) or fixed charges are not consistent with the AEMC's intention in drafting the pricing rule.

The AER has based one of its permitted pricing structures on option four contained in its issues paper. VENCORP recommended using option four and basing it on forecast maximum demand at peak times incorporating an adjustment for actual demand. While the use of forecast demand is necessary where historical demand data is not available (such as with a new user or new connection point), the AER considers this approach, with its adjustment for actual demand would, if applied to all users, create a more sophisticated and complicated pricing structure than necessary. However, it is noted that if VENCORP considers its pricing structure meets the NER requirements it is able to propose it as an alternative structure under the proposed guidelines.

The AER has, in accordance with clause 6A.25.2(b) of the NER, considered the desirability of consistent pricing structures across the NEM. While mandating one

⁶ AEMC, Rule Determination, *National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No. 22*, 21 December 2006, p.44.

permitted pricing structure may be beneficial in so far as the derivation of prices would be identical across the NEM, the AER is concerned that without transitional arrangements, price shocks may occur. In its pricing determination document, the AEMC indicated that transmission prices should be sufficiently stable and predictable to allow participants to plan and make long-term decisions without suffering price shocks.⁷ In specifying permitted pricing structures that are based solely on demand at times of greatest network utilisation and minimising price shocks by allowing TNSPs to propose alternative pricing structures, the AER has struck a balance between consistency and stability.

The AER must also determine price structures while having regard to the role of pricing structures in signalling network investment and utilisation decisions. The AEMC notes that it is network load during peak system conditions which drives network investment.⁸ To the extent locational prices are based on maximum demand at connection points and that lower locational prices are likely to identify more lightly loaded areas of the network, locational prices will provide efficient network utilisation signals and should result in efficient network investment decisions. Further, if users know in advance the broad period in which charges will be calculated they may alter their usage during this period to minimise their charges.

The proposed guidelines state:

The following measures of demand, when applied to a price calculated in accordance with clauses 6A.23.3(c)(1) and 6A.23.4(e), are permitted pricing structures:

- (1) The higher of the contracted agreed maximum demand as negotiated in a transmission customer's connection agreement or the transmission customer's actual maximum demand in the previous financial year expressed as \$/MW/day; or
- (2) Demand measured as the average of the transmission customer's maximum demand recorded at a connection point on the 10 weekdays when system demand is highest between the hours of 07:00 and 23:00 in the local time zone during the previous financial year expressed as \$/MW/day.

The benefit of the first option is that if a customer can maintain its demand under its contracted agreed maximum demand then it will be charged a known maximum amount. However, if a customer with a contracted agreed maximum demand exceeds its agreed demand it will be charged the higher amount, as well as the penalty outlined in the proposed guidelines. A user without a contracted agreed maximum demand may have its charge calculated using its actual maximum demand in the previous financial year.

There are a number of benefits of the second option. First, a user will know in advance that it needs to manage its demand on high network demand days, although it will not know in advance the exact days that will be used to determine the maximum demand

⁷ AEMC, Rule Determination, *National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No. 22*, 21 December 2006, p.10.

⁸ *Ibid.*, p.44.

values for calculating its charge. Second the charge will be based on actual maximum demand for its connection point as determined by the TNSP.

Both options recognise that it is demand which drives network investment and provide measures of demand that reflect the demand characteristics of the TNSP's network. The AER intends to conduct further analysis of the impact of locational prices on network investment and demand prior to releasing the final guidelines.

5.3.5 AER conclusion

While specifying a single pricing structure would result in all locational charges across the NEM being calculated in exactly the same manner, the AER considers that this would, at least in the short term, be at the expense of stability and predictability. It would also prevent future price structure innovation. As discussed above, the AER considers that the permitted pricing structures contained in the proposed guidelines provide an appropriate balance between consistency, stability and innovation.

5.4 Permitted pricing structures (postage stamp)

5.4.1 AER issues paper

In accordance with clause 6A.25.2(c) of the NER the final guidelines must specify or clarify permissible postage stamping structures for the prices for prescribed common services and the recovery of the non-locational component of prescribed TUOS services. In doing so the AER must consider the desirability of a consistent approach across the NEM, particularly for users with operations in multiple jurisdictions. Further the AER must consider the desirability of signalling to actual and potential users efficient investment and network utilisation decisions.

The issues paper identified a number of options which could be used as postage stamp structures including those allowed by the NER prior to the pricing rule being made. Interested parties were encouraged to suggest alternative structures if those included in the issues paper were unsuitable.

5.4.2 Issues raised in submissions

EnergyAustralia considered that to mandate either an energy only or capacity only price structure would disadvantage one group of users depending on whether they had a high or low load factor.⁹ It stated a preference for the approach contained in the old rules whereby an energy and capacity based charge are calculated and the one most favourable to the user is applied. EnergyAustralia stated that the postage stamp allocation is intended to recover a portion of network revenues in the least distortionary manner with the price signal affecting consumption arising from the locational component of revenues.

⁹ A network user's load factor is the ratio of their average demand to their peak demand.

ETNOF noted that the wording in the NER in relation to postage stamp structures introduces a significant change to what these charges were intended to do. It noted that in the past postage stamped general and common service charges were intended to be non-distortionary to participants' behaviour. ETNOF noted that under the new pricing rule, these charges could be designed to influence behaviour, however, ETNOF indicated that postage stamped structures cannot provide price signals. It stated a preference for maintaining the current postage stamp structure which is already consistent across the NEM and provided a broad signal for future investment as it encourages larger loads to manage their peak demands in order to reduce their demand based charges.

The MEU noted that the general charge (now referred to as the non-locational component of TUOS) is the 'other half' of TUOS. It stated that TUOS is driven by demand and recovered using a demand based charge, therefore the non-locational component of TUOS should also be recovered via a demand based charge and not an energy based charge. MEU considered that the postage stamping structures for the prices for prescribed common transmission services should also be based on demand. It considered that postage stamped structures could be based on contract demand, the highest demand in the previous 12 months or a similar approach. MEU noted that demand based structures provide signals to users not to exceed their contracted demand.

VENCorp considered that postage stamp prices should not distort a users consumption and investment decisions. It therefore considered that the structures contained in the NER immediately prior to the release of the new pricing rule were appropriate.

5.4.3 NAS findings

NAS recommended that the AER should include the current pricing structures for prescribed common transmission services and non-locational prescribed TUOS services as permitted pricing structures in its guidelines but allow a TNSP to propose alternative structures if they can be justified under the NER. NAS considered that retaining the current approaches would:

- Promote consistency of pricing structures across the NEM.
- Provide signals to encourage users to manage their consumption so as to reduce their maximum demand and therefore reduce their demand based charges. NAS considered that this would encourage the efficient use of the existing network (i.e. static efficiency).
- Provide signals for TNSPs to invest efficiently in their networks to the extent that users are optimising their use of the existing network.
- Recognise that not all prices are intended to provide the same price signals and so avoid 'over-signalling' prices.
- Allow innovation by enabling a TNSP to justify an alternative pricing approach under the NER if the TNSP considers it warranted.
- Promote stability by allowing a TNSP to retain its existing pricing structure.

5.4.4 AER considerations

Submissions from EnergyAustralia, ETNOF and VENCORP indicated a preference for maintaining the existing postage stamping structures. Under this approach a TNSP calculates an energy based price and a capacity based price and applies the price that results in the lowest charge for each connection point. In general TNSPs stated that there was no need to depart from the current approach; that a move to an energy charge only or capacity charge only would impact on different classes of users and would require transitional arrangements; and that existing arrangements are designed to recover revenue in the least distortionary manner and that if prices are postage stamped they are not able to provide signals. It was also stated that there is already consistency in approach across the NEM, apart from measurement units which can be readily changed.

On the other hand, the MEU stated a preference for postage stamp structures to be based on demand rather than through energy based or fixed charges. MEU held this position as it considered that the key driver of network development was demand.

Desirability of signalling

Clauses 6A.23.4(d) and (j) state that the prices for prescribed common transmission services and prices for the recovery of the adjusted non-locational component of prescribed transmission services must be based on a postage stamp basis. The NER defines postage stamping as a system of charging network users for transmission service or distribution service in which the price per unit is the same regardless of how much energy is used by the network user or the location in the transmission network or distribution network. Historically, postage stamping arrangements have been implemented for these services so that revenues related to them are recovered in a way that minimises distortion to a network user's consumption and investment decisions.

The MEU's option of applying a demand based approach to common services and non-locational prices may distort some network user's consumption and investment decisions, in particular those whose charges are currently based on an energy price. The AER considers that signals regarding a user's impact on the network are provided through the demand based pricing structure for the locational component of TUOS charges and that a change to a demand only based approach for postage stamped charges could potentially result in oversignalling. The AER also agrees with NAS that the AEMC did not intend prices for common and locational services to send "locational investment and network usage signals" and that TNSPs postage stamped prices need not only be based on demand.¹⁰

Desirability of consistency

In specifying and clarifying permissible postage stamping pricing structures the AER is required to consider the desirability of consistency across the NEM, particularly for users with operations in multiple jurisdictions. The AER agrees with NAS that consistency does not necessarily mean that TNSP's prices need to be identical or that the AER needs to impose a single mandatory pricing structure across all TNSPs. The

¹⁰ AEMC, Rule Determination, *National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No. 22*, 21 December 2006, p.44.

AER also considers that it needs to take into account other factors such as price stability and innovation in determining the appropriate pricing structures to be applied.

From its review of submissions and consultations with interested parties, the AER agrees with NAS' recommendation that the current postage stamping arrangements for common service prices and non-locational TUOS prices should be maintained. The AER has come to this view for the following reasons:

- The existing approach to postage stamping price structures is designed to minimise distortions in the recovery of revenues related to common transmission services and non-locational TUOS services.
- The proposed pricing structure is already being consistently applied by TNSP's across the NEM, with the only difference being measurement units.
- The approach maintains the current pricing structure arrangements in the NEM and therefore promotes price stability and predictability for network users.
- The AEMC indicates in its pricing rule determination that changes to pricing arrangements should not be made unless there is some compelling reason to do so. The AER has not identified a compelling reason to change from the existing postage stamping price structure arrangements.

The AER has decided not to allow alternative postage stamping structures as it considers the approach outlined in the proposed guidelines is widely accepted by TNSPs and provides for a consistent approach.

5.4.5 AER conclusion

The AER has considered the rules and submissions on the issues paper. It has decided to maintain the existing postage stamping pricing structure in its guidelines for reasons of consistency, price stability and predictability. This approach requires a TNSP to calculate energy and agreed maximum demand based prices and to apply the price that results in the lowest charge to the network user.

5.5 Attribution of transmission system assets to categories of prescribed transmission services

5.5.1 AER issues paper

In accordance with clause 6A.25.2(d) of the NER the AER must specify or clarify the types of transmission system assets that are directly attributable to each category of prescribed transmission services. The AER must also consider the desirability of consistency of cost allocation across the NEM. In the issues paper, assets were listed under different categories of prescribed transmission services. Interested parties were requested to consider the lists of assets and comment on any additions or deletions they considered appropriate.

5.5.2 Issues raised in submissions

EnergyAustralia stated that there is no need to alter the existing categories of asset types.

ETNOF recommended that a list of assets similar to that contained in schedule 6.2 of the old rules should be included in the final guidelines. It noted that additions to the list of transmission asset types could include assets which have been categorised under the old rules as prescribed entry services, for example radial lines from the substation to the agreed connection point at the generator.

MEU considered that the final guidelines should define the point at which entry and exit assets become network assets. MEU stated that connection assets are assets which can be removed from service without impacting another user and that an entry point is where energy is injected into the network and an exit point is where energy is extracted from the network. MEU considered that assets allocated to prescribed common transmission services should only be those assets which, if removed, would impact on every user connected to the network. MEU also stated that an entry point can become an exit point and there is a need to establish a cost sharing mechanism to accommodate such circumstances.

MEU also provided the AER with a supplementary submission stating that many entry points should be classified as both entry and exit points. It considered that when a generator (without blackstart capability) is not injecting energy into the network it is a consumer of energy via the same connection point and therefore should pay TUOS and common service charges. Additionally, MEU considered that there is currently no incentive for transmission network users to introduce self-generation. It considered that if charges were based on demand within specific times, there would be an incentive for users to use non-network generation during these peak times.

NGF indicated that based on an interpretation of the NER, there is a potential conflict between the priority ordering process outlined in clause 6A.23.2(d) of the NER and the AEMC's intention that generators not be charged for deep connection costs. It was also concerned about the risk of asset re-classification as a result of network re-configuration, other than at the generator's request. NGF was concerned that price shocks could result from the re-classification of assets which were previously treated as shared network to prescribed entry assets. It sought to have provisions placed into the final guidelines which prevent the possibility of re-classification of assets from prescribed common, prescribed TUOS or prescribed exit services to prescribed entry services. If this was not possible, NGF requested that the final guidelines include transitional provisions to mitigate price shocks, limiting the year on year change.

VENCorp noted that it does not recover costs from prescribed entry and exit services, however, it stated that it does consult with SP Ausnet to determine the correct cost allocation between shared and common service assets. VENCorp stated that it agreed with the list of assets in the issues paper which are likely to be identified as prescribed common transmission assets.

5.5.3 NAS findings

NAS considered that the AER should specify the types of transmission assets that are directly attributable to each category of prescribed transmission service having regard to a number of general principles, including the need for consistency, stability and innovation.

NAS referred to the AEMC's pricing rule determination and its discussion that the development of part J of the NER was based on '...confirming the broad acceptability of the approach to pricing in the existing Rules.'¹¹ NAS stated that it had not been able to assess the merits of the MEU's alternative asset allocation proposal and therefore was unsure about its practicality, cost and impact and could not recommend it for use in the proposed guidelines.

NAS recommended retaining the approach the AER detailed in its issues paper which was based on schedule 6.2 of the old rules unless a TNSP proposed an alternative approach which could be justified under the NER. NAS considered that the current approach reflected the AEMC's view about the broad acceptability of the current pricing arrangements and promoted stability and predictability by allowing TNSPs to continue to apply their current asset allocation approach. However, NAS considered that allowing TNSPs to propose an alternative asset allocation approach would provide for innovation.

5.5.4 AER considerations

Schedule 6.2 of the old rules provided a detailed explanation of the allocation of assets to categories of prescribed transmission services. EnergyAustralia and ETNOF were in favour of retaining the information contained in schedule 6.2 of the old rules and therefore maintaining the current approach. VENCORP also agreed with the list of prescribed common service transmission assets contained in the issues paper.

Schedule 6.2 refers to assets which are 'fully dedicated' to providing connection services whereas under clause 6A.25.2(d) of the NER, the AER must specify or clarify assets that are 'directly attributable' to categories of prescribed transmission service. In addition, schedule 6.2 does not specifically distinguish between prescribed entry and exit services. However, the AER notes that while these sections of schedule 6.2 of the old rules cannot be included in the proposed guidelines as they currently are, schedule 6.2 provides guidance on a workable asset allocation approach.

MEU has suggested an alternative method of allocation of assets to categories of prescribed transmission service. The AER has not had the opportunity to fully assess the implications of the MEU's methodology including any implementation issues associated with it. The AER intends to consult with TNSPs to determine the viability of the MEU's proposal.

In relation to generator entry points being classified as both entry and exit points and generators incurring exit, TUOS and common service charges, the AER considers this

¹¹ AEMC, Rule Determination, *National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No. 22*, 21 December 2006, p.26

to be beyond the scope of the proposed guidelines. The proposed guidelines must specify the types of assets directly attributable to categories of prescribed transmission service not determine whether connection points should be reclassified as entry and exit points.

In response to issues raised by the NGF, the AER notes that schedule 6.2 of the old rules refers to assets which are ‘fully dedicated’ to a generator or customer while the new part J of the NER refers to assets being ‘directly attributable’ to the categories of transmission service. While the AER acknowledges that it is possible that assets which were previously treated as shared network assets may now be treated as prescribed entry service assets, it is beyond the scope of the guidelines to address the NGF’s concerns.

The term directly attributable has not been defined in the NER, however, in its rule determination document the AEMC provided guidance as to its meaning.¹²

‘The expression “directly attributable” is intended to have the same meaning as it has in the Revenue Rule. That is, it refers to assets that are used or required to provide the relevant pricing category of prescribed transmission service.’

In developing the proposed guidelines, the AER has included the AEMC’s definition in the glossary of the proposed guidelines.

In clarifying the types of assets directly attributable to categories of transmission assets, the AER must have regard for the desirability of consistency of cost allocation across the NEM. Asset costs are assigned to assets in accordance with clauses 6A.22.3 and 6A.22.4 of the NER and should promote consistency across the NEM.

The AER has considered providing for innovation in the allocation of assets to services by allowing TNSPs to propose an alternative asset allocation approach. However, the AER considers that the allocation of assets to services should be a methodological process and does not consider that there are advantages from allowing variation between TNSPs. Further, one asset allocation methodology will promote consistency across the NEM.

5.5.5 AER conclusion

The AER has provided a list of transmission assets for each category of prescribed transmission service based on the allocation contained in schedule 6.2 of the old rules. It has decided against allowing TNSPs to propose alternative asset allocation approaches at this stage.

¹² AEMC, Rule Determination, *National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No. 22*, 21 December 2006, p.34.

5.6 Disclosure of information

5.6.1 AER issues paper

The issues paper noted that the final guidelines must clarify the parts of a proposed pricing methodology or the information accompanying it that will not be publicly disclosed without the consent of the TNSP. The issues paper indicated that details surrounding prudent discounts and commercial arrangements with third parties might be considered to be confidential information and therefore likely not to be publicly disclosed.

5.6.2 Issues raised in submissions

EnergyAustralia considered that any information pertaining to a single customer's price or connection must not be published. Further it stated that the AER has confidentiality obligations as outlined in the Trade Practices Act and the National Electricity Law which contain procedural requirements and the need for consideration on a case by case basis.

ETNOF considered that information surrounding prudent discounts which allows identification of discount rates charged to particular customers should not be publicly disclosed. It also considered that where a TNSP has developed specialised software or systems with significant intellectual property these should not be publicly disclosed.

VENCorp stated that proposed pricing methodologies should be capable of preparation by TNSPs in a manner that does not raise confidentiality issues. To facilitate this, the AER should not request information likely to be confidential. VENCorp suggested that any worked examples should be hypothetical examples based on hypothetical data.

MEU considered that all information should be made available unless it pertains to a specific user.

5.6.3 NAS findings

In considering the disclosure of information, NAS referred to the AEMC's discussion in its pricing rule determination that transparency is important in promoting good regulatory practice and furthering the NEM objective.

NAS stated that it appeared that the term 'confidential information' as defined in the NER does not relate to information that is provided to the AER, but rather only to a registered participant and the National Electricity Market Management Company (NEMMCO). However, NAS stated that this should not prevent the AER from agreeing to withhold from publication confidential or commercially sensitive information.

NAS considered that the proposed guidelines should require a TNSP to provide both a confidential and non-confidential version of its proposed pricing methodology to the AER and justify why it considers any information to be confidential.

5.6.4 AER considerations

The AER must deal with issues of confidentiality under section 44AAF of the Trade Practices Act. The AER recognises that there may be information which should not be publicly disclosed without the consent of the TNSP. While some TNSPs may be able to develop proposed pricing methodologies which comply with the proposed guidelines and the NER and not raise confidentiality concerns, others may not.

The AER considers that confidential or commercially sensitive information is likely to include information which may be used to infer a particular customer's price or charge, premises, negotiated discounts, prudential requirements or other commercial arrangements relating to its electricity supply. Therefore, if a TNSP needs to supply such information to the AER, to meet the requirements of the proposed guidelines and the NER, it should do so in a confidential version of its proposed pricing methodology justifying its claim for confidentiality. The AER will not publicly disclose this version of a TNSP's proposed pricing methodology but if it disagrees with a TNSP's claim for confidentiality, it will notify the TNSP of its view and give the TNSP the opportunity to withdraw the information. The AER will not take the withdrawn information in account in assessing the TNSP's proposed pricing methodology.

5.6.5 AER conclusion

The AER considers that confidential or commercially sensitive information is likely to include information which may be used to infer a particular customer's price or charge, premises, negotiated discounts, prudential requirements or other commercial arrangements relating to its electricity supply. If a TNSP needs to supply such information to the AER to meet the requirements of the proposed guidelines and the NER, it should do so in a confidential version of its proposed pricing methodology.

6. Consultation process

The AER will engage in the following consultation process:

- publish this explanatory statement, the proposed guidelines and invite submissions on the proposed guidelines
- consider submissions on the proposed guidelines
- publish the final guidelines by 31 October 2007.

7. Invitation for written submissions

Interested parties are invited to make written submissions to the AER on the proposed guidelines.

The AER prefers that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will therefore be treated as public

documents unless otherwise requested. Parties wishing to submit confidential information are requested to:

- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission, in addition to a confidential one.

All non-confidential submissions will be placed on the AER's website.

Any submissions must be received by close of business 5 September 2007 and should be addressed to:

Mr Mike Buckley
General Manager
Network Regulation North Branch
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601
Email: AERInquiry.PMG@aer.gov.au

8. Glossary

AARR means the aggregate annual revenue requirement as defined in the National Electricity Rules

ASRR means the annual service revenue requirement as defined in the National Electricity Rules

AER means the Australian Energy Regulator

Appointing provider has the meaning ascribed to it in clause 6A.29.1(a) of the National Electricity Rules

Capacity based price means a price per unit of contracted capacity

Contracted agreed maximum demand means the agreed maximum demand negotiated between a TNSP and a transmission customer

CRNP means cost reflective network pricing

Directly attributable in relation to transmission assets refers to assets that are used or required to provide the relevant pricing category of prescribed transmission service.¹³

Guidelines means the proposed pricing methodology guidelines

National Electricity Rules or NER means the rules as defined in the National Electricity Law

Old rules means the National Electricity Rules in force immediately prior to the commencement of the National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No. 22

TNSP means transmission network service provider as defined in the National Electricity Rules

TUOS means transmission use of system

¹³ AEMC, Rule Determination, *National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No. 22*, 21 December 2006, p.34.