

Decision

**Statement of Principles for the Regulation
of Transmission Revenues**

**Guidelines for the Negotiation of Discounted
Transmission Charges**

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Glossary

Code	National Electricity Code
Commission	The Australian Competition and Consumer Commission
CRNP	Cost Reflective Network Pricing
Discussion Paper	Draft guidelines for the Negotiation of Discounted Transmission Charges
DRP	Draft Regulatory Principles
GEIDB	Gladstone Economic Industry Development Board
Guidelines	Guidelines for the Negotiation of Discounted Transmission Charges
NECA	National Electricity Code Administrator Ltd
NECG	Network Economics Consulting Group
NEM	National Electricity Market
NSP	Network Service Provider
TNSP	Transmission Network Service Provider
TUOS	Transmission Use of System
VAW Kurri	VAW Kurri Kurri Pty Ltd
VENCorp	The Victorian Energy Networks Corporation

Executive Summary

Clause 6.5.8 of the National Electricity Code (Code) refers to ACCC Guidelines for the Negotiation of Discounted Transmission Charges (henceforth, the Guidelines). The Code permits a TNSP to recover the amount of a discount to a transmission customer's general and/or common service charges from other transmission customers provided it is satisfied that it can demonstrate that the discount complies with the Guidelines. At the subsequent revenue reset, the ACCC may 'claw back' the recovered revenue if it decides the discount did not meet the Guidelines.

As described in this Decision Paper, the Commission has now developed Guidelines which, following their publication on the Commission's website (<http://www.accc.gov.au/electric/regulation.html>) on 3 May 2002, will constitute the Guidelines referred to in the Code.

The Commission released a Discussion Paper containing draft guidelines for public comment on 10 October 2001. The submissions received were considered in developing the final Guidelines, as discussed in this Decision Paper. The Commission has also taken into account issues arising out of an assessment of an application for discount recovery received in accordance with clause 6.5.8(c)(1) of the Code.

The Discussion Paper proposed three guidelines. In the light of submissions, the Commission has added a fourth guideline to deal with pre-existing discount arrangements and has refined the wording of Guideline 1. It has also clarified procedures for assessing applications from TNSPs to recover the amounts of discounts from other customers. In accordance with the Code, such applications will be formally considered at each revenue determination. However there is also provision for a TNSP to apply for a letter of guidance from the Commission at the time the discount is being negotiated.

A copy of the Guidelines is included at Annex A to this Decision Paper.

The Commission intends to monitor the application of the Guidelines and, should experience show that they are not meeting their objectives, it may revise them at some later date following due consultation with all relevant stakeholders.

1. Introduction

On 21 September 2001 the Commission authorised, subject to a number of conditions, changes to the network pricing arrangements in the National Electricity Code (Code).¹ The Code now allows Transmission Network Service Providers (TNSPs) to recover the amount of a negotiated discount on the Transmission Use of System (TUOS) general and/or common services charge from other transmission customers.² A TNSP can begin to recover the amount of the discount from other transmission customers from the time it is negotiated provided that the TNSP is satisfied that it can demonstrate that the discount complied with the Guidelines for the Negotiation of Discounted Transmission Charges. However, if at the next regulatory reset, the TNSP is unable to demonstrate to the Commission that the discount complies with the Guidelines, the Commission may decide to ‘claw back’ the revenue that the TNSP had recovered.³

This document sets out the Commission’s decision as to the content of the Guidelines for the Negotiation of Discounted Transmission Charges. Section 2 discusses a consultancy undertaken by the Commission to aid in the development of a Discussion Paper containing draft guidelines. Section 3 summarises the draft guidelines, which were released for comment in October 2001. Parties who responded with written submissions are listed in Section 4. Issues raised in the submissions and the Commission’s responses to them are contained in Section 5 and the Commission’s decision is presented in Section 6. Annex A contains the Guidelines for the Negotiation of Discounted Transmission Charges.

2. NECG consultancy

The Commission engaged the Network Economics Consulting Group (NECG) to advise on several issues that may be faced in developing and implementing discounting guidelines. In summary the NECG’s report provided advice on:

- an economic framework for negotiating discounts on the general charges to be recovered at least partially from other network users;
- the scope for determining walk-away prices in each instance;
- the relative merits of a regime that allows a fixed proportion of any discount to be recovered, rather than case-by-case assessment;
- the incentive mechanisms for TNSPs to discourage unnecessary discounts; and
- the role disclosure rules may have on a TNSP’s incentives.

¹ Amendments to the National Electricity Code, *Network pricing and market network service providers – determination*, ACCC, 21 September 2001.

² See National Electricity Code, clauses 6.5.8(c) and 6.5.8(e).

³ See National Electricity Code, clause 6.2.4(c)(8a).

3. Draft guidelines

The report by NECG aided in the development of a Discussion Paper containing draft discount guidelines, which the Commission released for public comment on 10 October 2001. The declared aims of the guidelines were twofold: to provide a framework whereby TNSPs have the necessary incentives to offer economic discounts and to provide certainty to TNSPs to enable timely discount negotiations to be undertaken. The Discussion Paper concluded that TNSPs may sometimes be inclined to offer larger discounts than necessary, with consequentially higher rates of market distortion. Hence the following guideline was proposed.

Guideline 1: The TNSP must demonstrate that the discount is no larger than necessary.

It was argued in the Discussion Paper that a discount may leave other network users worse off. The beneficiary of the discount will increase its usage of the network, thus perhaps justifying augmentation or avoiding asset devaluation. If so, charges payable by other network users may increase unless the TNSP itself absorbs some of the discount. Hence a second guideline was considered necessary.

Guideline 2: The TNSP must demonstrate that no other network user is worse off compared to the situation if the discount is not offered.

It was considered sufficient for the TNSP to show either that there would be no increase in its revenue cap or else that the increase would be offset by the increased charges payable by the discount beneficiary.

The Discussion Paper recognised that it would not always be cost-effective to perform the detailed analysis necessary to demonstrate conformance with draft guidelines 1 and 2, hence an alternative ‘safe harbour’ route was proposed.

Guideline 3: Recovery of 70% of the cost of a discount from network users will receive automatic approval providing the TNSP has agreed to absorb the remaining 30%.

The Discussion Paper also recognised the benefits of providing certainty to the market. It therefore suggested that approval, once given, should extend for the life of the discounting agreement.

4. Submissions on draft guidelines

Upon releasing the Discussion Paper the Commission called for submissions on the draft guidelines from interested parties. The Commission received seven submissions from the following parties:

- NSW Treasury;
- Energy Australia;
- GEIDB;
- VENCORP;
- Powerlink;
- VAW Kurri; and

- TransGrid.

The above submissions have been taken into consideration in finalising the Guidelines.

A copy of NECG's report, the Discussion Paper containing the draft guidelines and submissions from interested parties can be viewed on the Commission's website at the following address:

<http://www.accc.gov.au/electric/regulation.html>

5. Issues raised in submissions from interested parties

5.1 Obligation to provide information

Views of interested parties

VAW Kurri notes that in developing a case for a price discount, major customers will invariably require access to information that is peculiar to the relevant TNSP. It is concerned that there is insufficient obligation on the TNSP to provide required information to a discount applicant. VAW Kurri believes that the final guidelines should contain explicit statements to the effect that TNSPs should provide all the information reasonably requested by customers seeking to develop a case for a discount.

VENCorp notes that, as TNSPs will have to judge whether there is a genuine case for a discount, they must therefore be in position to obtain relevant information from the applicant. It believes that there should be an obligation on the applicant to provide sufficient information to a TNSP to assess its case for a discount. Energy Australia also noted that detailed information needed to be provided by a party seeking a discount.

Commission's considerations

The Code requires that negotiations regarding negotiable services are to be conducted in accordance with a framework, developed by a TNSP, that meets the requirements of clause 6.5.9. The framework should specify, amongst other things, that each party must negotiate in good faith and must disclose all relevant commercial information to the other. In the event that one party considers that the other has not complied with these requirements, it has recourse to dispute resolution. As the definition of 'negotiable services' includes discounting arrangements, a TNSP and a network user seeking a discount have access to such a framework in negotiating discounts to the general and common services charges.

It is considered that these provisions place sufficient obligation on the TNSP and the discount applicant to provide each other with all relevant information in order to enter into discount negotiations.

5.2 Indemnification of TNSPs

Views of interested parties

Energy Australia notes that TNSPs are required to judge the adequacy of the information put to them by a discount applicant before submitting a discount application to the Commission. It notes that a TNSP is likely to be placed in a position of having to judge claims by a customer that lie outside its area of expertise and therefore could be the subject of debate. Energy Australia believes that responsibility should lie with the customer to provide correct supporting information, with the TNSP indemnified from loss if it relies upon information which subsequently proves to be incorrect.

Commission's considerations

The Commission accepts the principle that TNSPs should not be required to assume risks that they are not in a position to manage. However, it is anticipated that the negotiation framework in the Code (see clause 6.5.9) provides sufficient scope for TNSPs to obtain the information that they need to assess the bona fides of a discount application. It does not therefore seem unreasonable to require TNSPs to be accountable for their assessments.

5.3 Publication of discounting information

Views of interested parties

TransGrid notes that the Commission intends to publish information regarding negotiated discounts. TransGrid is not convinced of the need for public disclosure of such information but believes that it would be useful for the Commission, as part of the worked example, to indicate what information the Commission intends to publish in relation to the example.⁴ TransGrid also notes that on the information presented in the worked example, there appears to be no costs to be recovered from other network users and that other network users actually see a cost reduction.

TransGrid also notes that clause 6.5.9(b)(7) of the Code requires TNSPs to publish information on the aggregate amount of discounts determined under the negotiating framework in each financial year. It questions whether or not responsibility for publishing such information has shifted from the Commission to TNSPs or whether both TNSPs and the Commission are required to publish such information.

A related issue, raised by Energy Australia, is the potential for there to be only one or at most a few such discount cases each financial year and the difficulties this will pose for the Commission in maintaining the confidentiality of the information.

TransGrid agrees and argues that it would see problems in publishing aggregate data unless a TNSP had at least three, and given cases involving cross-ownership issues, four discount cases.

⁴ The Commission's Discussion Paper contained a worked example illustrating how the draft guidelines might be applied.

VENCorp considers that public disclosure of outcomes may have a down-side by encouraging enquires that would be unlikely to satisfy the guidelines.

Powerlink considers that the requirement for the justification for recovery of the discount to be included in the TNSP's revenue application, which is made public, is in conflict with the acknowledgment by the Commission that commercially sensitive information will not be made public. Powerlink believes that any justification that includes commercially sensitive information should be excluded from being published as part of the TNSP revenue application and that the guidelines should be amended to reflect this.

Commission's considerations

As stated in its network pricing determination the Commission considers that where negotiated discounts are to be recovered from other network users, these users have a right to know the amount of the additional costs they will be required to bear as a result of the discount being offered. Hence, the Commission believes that there is a need for public disclosure of such information. The Commission does, however, agree that it would be useful to indicate the information that would be published in relation to the worked example and has amended the worked example accordingly.

The Commission agrees that on the basis of the information presented in the worked example, other network users are actually likely to be better off as a result of the discount having been offered. On the other hand, if some of the information was incorrect, other users could be up to \$1,200,000 per year worse off as a group. Thus, it seems reasonable that those users should be aware (at least in aggregate terms) of the size of the discounts provided and the amounts being recovered from them (that is, not being absorbed by the TNSP).

Clause 6.2.5(b)(5) states that the Commission may publish aggregate information on the amount of any discounts granted by a TNSP and the percentage of the discount to be recovered from other network users in a financial year.⁵ The Commission agrees with TransGrid that there appears to be a duplicate requirement in the Code in relation to the publishing of discount information. However there may be ways to avoid duplication in practice. The Commission intends to liaise with TNSP's to explore the possibility that publication by the ACCC can be made to satisfy the Code requirements.

The Commission agrees that special problems may arise where a TNSP has only negotiated a small number of discounts in a financial year. The Commission's network pricing determination makes it clear that commercially sensitive information should not be made public and that the Commission intends to publish only aggregate information. This position was reaffirmed in the Discussion Paper.⁶ The Commission therefore undertakes to aggregate the published information to such an extent that it retains its

⁵ Information on the amount of each discount offered and the percentage of each discount to be recovered from other network users is to be included in a TNSP's annual compliance statement to the Commission (see clause 6.2.5(a1)).

⁶ See discussion under the heading of Regulatory process.

confidentiality. This may mean that it is necessary to consolidate information above the TNSP level to the regional level or even higher if confidentiality issues remain.

The Commission agrees that commercially sensitive information demonstrating compliance with the Guidelines should not be made public and that such information could for example, be included as a confidential attachment to a TNSP's revenue application. The regulatory process area within the Guidelines now contains information on how the discount application is to be made.

5.4 The term of the discount

Views of interested parties

VENCorp noted that the draft guidelines are silent on the term of any negotiated discount and therefore it presumes that there is no limitation on this aspect of the negotiations. It suggests that if there is to be a limit, or if the proposed term will affect the Commission's assessment that this should be specified.

Commission's considerations

The Commission has intentionally not stipulated the maximum length of a discount term. However, in assessing whether a discount meets the guidelines the Commission intends to assess more rigorously discounts of a longer term than those of a shorter duration. In accordance with VENCORP's suggestion, the Guidelines now indicate that the term of any discount is a matter for the parties to negotiate.

5.5 Discount may only apply to part of the customer's entire load

Views of interested parties

TransGrid understands that it is the Commission's intention that the discount be no larger than necessary to prevent the beneficiary from taking or ceasing to take the portion of the load, which is subject to the discount. It believes that Guidelines 1 and 2 need to be framed in terms of the part of the load which is subject to the discount rather than the beneficiary's whole load. TransGrid states that the draft guidelines seem to imply the user's behaviour from the perspective of the whole load.

Commission's considerations

The Commission agrees that the discount may, in certain circumstances, only apply to a portion of a customer's entire load, in which case Guidelines 1 and 2 should only be applied to that portion. It is agreed that this should be the intent of the Guidelines. The final guidelines have been amended in accordance with this statement.

5.6 Beneficiary versus recipient

Views of interested parties

TransGrid notes that the draft guidelines are written in terms of the effect of the discount on the recipient of the discount. However, it notes that there will be occasions

where the ‘recipient’ is not the beneficiary of the discount. For example, in NSW a large customer connected to Energy Australia’s network may seek to negotiate a discount with both Energy Australia and TransGrid (the two TNSPs in that jurisdiction). In such circumstances, Energy Australia would be the party connected to TransGrid’s network and therefore both the party liable to pay network charges and the ‘recipient’ of any TransGrid discount. However, the customer would be the beneficiary of the discount. TransGrid believes that it would be better if the Guidelines referred to the beneficiary of the discount rather than the recipient.

Commission’s considerations

The Commission agrees that the terminology in the guidelines should be modified as suggested by TransGrid. As such all references to the word ‘recipient’ in the Guidelines have been changed to the word ‘beneficiary’.

5.7 Joint discount applications

Views of interested parties

TransGrid’s above example also raises the issue that on occasions a discount applicant may need to negotiate a discount with more than one TNSP. Energy Australia requested that the Commission clarify the application process when a bypass proposal affects more than one TNSP. It suggested that, when appropriate, the request to recover the cost of a discount from other network users should be dealt with by way of a combined submission to the Commission.

Commission’s considerations

Application of the Guidelines where two or more TNSPs share a network requires consideration of all the relevant facts. This includes the extent of any discounting proposed by the other TNSPs. For example, Guideline 1 requires that the discount should be no larger than necessary to prevent the general or common service charges distorting the customers’ behaviour. Demonstration of this would require a detailed analysis of the operation of the specific transmission network involved, inclusive of all network service providers who share that network.

The Commission therefore considers that there would be benefit in the application being made jointly, or at least concurrently. If applications were not joint or concurrent, the Commission may be forced to make conservative assumptions regarding the extent of discounting by other TNSPs. This may result in approval being refused or deferred, simply because of a lack of information that would otherwise support cost recovery.

It is likely to be in all parties’ interest for the initial discount negotiations to involve all parties (utilising the 6.5.9 negotiating framework) and for a joint application or at least concurrent applications to be made to the Commission for approval of cost recovery. However, the Code clearly provides for the transmission customer to negotiate separately with each TNSP if it so wishes. As such the Commission considers that it should be left to the customer’s discretion as to how to proceed.

5.8 Floor to the general charge

Views of interested parties

Energy Australia notes that in its' case usage charges are based on half the cost of system assets and that as a result it may be appropriate not to allow complete discounting of the general charge.

Commission's considerations

The Commission agrees that a Cost Reflective Network Pricing (CRNP) method, based on 50 per cent of asset costs, may sometimes understate the incremental cost of transmission service. In those circumstances, full discounting of the general charge could result in an effective cross-subsidy. However, the recent network pricing code changes permit TNSPs to adopt an alternative 'modified CRNP' method that will allocate up to 100 per cent of asset costs (depending on asset utilisation). The methodology for setting usage charges is also to be further reviewed by NECA. There are also likely to be practical difficulties in deciding whether or not the usage charge accurately reflects incremental costs in individual cases and thus whether or not the discounting floor should be adjusted in those cases. In any case, Guidelines 1 and 2 provide some assurance that discounts are no larger than necessary.

5.9 Up-front assessment of discount applications

Views of interested parties

VENCorp favours the option of having the Commission undertake an up-front assessment of the validity of a discount, rather than wait until the 5 yearly regulatory review period occurs. Without this it argues that there may be a limit on the number of discounts offered, or that risk premiums may be factored into the discounts offered to customers. VAW Kurri also supported this approach. It believes that in consideration of up-front approval many customers would be willing to reimburse the Commission for the allocation of resources to this task and associated costs.

Commission's considerations

The Commission has reviewed the option of it undertaking an up-front assessment of the validity of a discount and considers that there is merit in providing up-front guidance on whether the discount application complies with the Commission's Guidelines.

The Commission notes that the Code requires it to undertake formal approval of the discount when next setting a revenue cap for the TNSP party to the discount. The Commission is, however, willing to provide up-front guidance to TNSPs on whether the recovery of the discount will comply with the Commission's Guidelines. Such guidance will only be provided on the basis that the TNSP complies with the information disclosure requirements set out below and that any views expressed by the

Commission are indicative and cannot constitute formal approval of the recovery of the discount under clause 6.5.8(e).

Where the Commission has indicated that, in its opinion, the recovery of a discount will comply with the Guidelines, the Commission would not anticipate departing from this opinion in its formal assessment of the discount unless:

- information provided to the Commission in forming this opinion was incorrect or further information becomes available which would have justified the Commission forming a different opinion; or
- forecasts used by the TNSP in its assessment of the discount were not made or relied on in good faith or were unreasonable (see note below).

Note: The Commission acknowledges that some disparity between forecast and actual data is inevitable. It is not the Commission's intention that this would provide grounds to re-assess a discount unless the disparity is so great as to suggest that the use of the forecasts by the TNSP was unreasonable. Accordingly, it is important that TNSPs exercise due care and diligence in assessing the recovery of a discount against these Guidelines and advise the Commission as soon as possible if the information provided to the Commission is found to be incorrect or if new information emerges that could justify a re-assessment of a discount.

The Commission notes that the formal process in the Code envisages that a TNSP will satisfy itself that a discount is likely to comply with the Guidelines before approaching the Commission at the regulatory reset. The TNSP's assessment would be based on information supplied by the customer during the discount negotiations, information provided from independent experts and/or its own knowledge of network options and costs.

Likewise, the Commission expects that the TNSP will satisfy itself that a discount is likely to satisfy the Guidelines before seeking a letter of guidance from the Commission. Nevertheless, the Commission is also prepared to review applications in the special circumstance where an irreconcilable difference has arisen between the customer and the TNSP as to whether or not the proposed discount would satisfy the Guidelines.

5.10 Re-assessment of the discount at revenue resets

Views of interested parties

In its Discussion Paper containing draft guidelines (see page 7) the Commission stated that, "In order to accommodate the desire for regulatory certainty the Commission is of the view that once a discount has been assessed against the Guidelines, as part of the regulatory review process, it would not be re-assessed, except at the request of the TNSP". Although strongly supporting this principle, as it would provide regulatory certainty for all parties, TransGrid questions whether the Commission has the authority to make such a statement and requests that the Commission confirm its powers to do so. TransGrid endorses codification of the principle as it considers that it would provide regulatory certainty for all parties on this issue.

NSW Treasury also supported the Commission's statement as it considered that it would promote certainty in the provision of efficient discounts. However, NSW Treasury also seeks assurance from the Commission that any *ex post* analysis of a discount against the Guidelines be conducted as if it were done at the time the discount was given. It argues that a discount made in good faith may appear several months or years later, in light of new information not available to the TNSP at the time of the discount, to breach the Guidelines. NSW Treasury believes that TNSPs should not be subject to this risk, being a risk that is outside their ability to control.

Commission's considerations

The Commission does not have the authority to make a statement that once a discount has been assessed against the Guidelines, it would not be reassessed, except at the request of a TNSP. The Code specifically requires the Commission to consider, at each regulatory reset, whether to reduce a revenue cap to take into account the recovery of a discount during the preceding regulatory control period (see clause 6.5.8(e)). This means that, where a discount operates over greater than one regulatory control period, the Commission is required to consider at each revenue cap review whether or not the recovery of the discount from other network users was permissible.

However, where the recovery of a discount has been approved by the Commission under clause 6.5.8(e) at the first reset following the negotiation of the discount, the Commission would not anticipate departing from this approval except in the following circumstances:

- where information provided to the Commission in forming its opinion was incorrect or if some pertinent information was not made available to the Commission in the original application; or
- where forecasts used by the TNSP in its assessment of the discount were not made or relied on in good faith or were unreasonable.

In subsequent resets, TNSPs will not have to submit additional material to demonstrate that the recovery of the discount satisfies the Guidelines unless specifically requested to do so by the Commission. The Commission also notes that, should an interested party require greater certainty on this issue, it is open for it to put a Code change application to NECA that such a principle be codified.

The Commission agrees with NSW Treasury that any *ex post* assessment of a discount application should be conducted as if it were done at the time the discount was negotiated, subject to the above caveats. The Guidelines have now been clarified to this effect.

5.11 Guideline 1: Discount no larger than necessary

Views of interested parties

NSW Treasury does not support TNSPs discounting by more than necessary to prevent inefficient by-pass. However, it disagrees that Guideline 1 is necessary to achieve this. It argues that TNSP's will be concerned at the risk of losing other network customers,

with consequent asset devaluation if they shift the extra charges onto them unnecessarily. It believes therefore that TNSPs are already incentivised not to provide a discount to any given customer by more than what is necessary to prevent inefficient by-pass.

NSW Treasury does not believe that Guideline 1 is inconsistent with efficient behaviour but states that economic efficiency may be consistent with a wide range of price levels and structures. It believes such a guideline will create additional barriers to the offering of discounts and has the effect of potentially interposing the Commission in the commercial negotiations between the TNSP and customers.

If the Commission chooses to keep the guideline NSW Treasury submits that for the sake of clarity, it should be reworded to clearly indicate that the issue is not ‘distortion’ *per se*, but avoidance of a customer taking an inefficient alternative option. NSW Treasury suggests that the guideline should read: “The discount offered on the general and common services charges should be no larger than that necessary to prevent the customer disconnecting from, or choosing not to connect to, the TNSP’s network”.

TransGrid also has concerns with the use of the word ‘distorting’ in Guideline 1. Although agreeing with the intent of the guideline, TransGrid was unsure whether the word ‘distorting’ simply meant ‘change the network user’s behaviour’ or ‘change the network user’s behaviour to the point of adopting an alternative option.’ Although agreeing that the worked example in the draft guidelines implies that the latter meaning is intended, TransGrid believes that it should be clarified in the Guidelines.

Commission’s considerations

NSW Treasury argues that Guideline 1 is unnecessary, as TNSPs will be concerned at the risk of losing other network customers with consequent asset devaluation if they shift extra charges onto these customers. It is not obvious, however, that this provides a cogent discipline on the TNSP. The argument might be stronger if there existed a history of TNSPs arguing against revenue cap increases, on the grounds of the impact on their customer base. It is important to note that a larger than necessary discount will not distort a beneficiary’s behaviour (assuming it still pays incremental cost) but will unnecessarily increase amounts to be recovered from other network users through the general and common service charges. Although those charges are structured so as to minimise their distortionary impacts, they will not be totally non-distortionary. Hence increasing the size of those charges raises the risk they will distort other network users’ behaviour.

The Commission agrees that the meaning of the words ‘distorting the user’s behaviour’ are not as clear as they could be and that it is desirable for Guideline 1 to be expressed more clearly. However, the wording proposed by NSW Treasury is somewhat narrow in its application. It excludes situations where an existing user is contemplating increasing its usage of electricity (for example, through increasing the size of its plant).

TransGrid suggests replacing ‘distorting the user’s behaviour’ with ‘changing the customer’s behaviour to the point of adopting an alternative option’. The Commission considers that the wording proposed by TransGrid largely captures the intended meaning of Guideline 1. The Commission also considers that the guideline could be

further clarified by stating that it is the ‘most commercially’ attractive alternative that is important in consideration of this guideline. It therefore considers that the wording of Guideline 1 should be changed to:

“The discount offered should be no larger than that necessary to prevent the general and common services charges altering the beneficiary’s behaviour to the point of adopting the most commercially attractive alternative in place of the course of action the beneficiary would have adopted if no such charges were levied.”

5.12 Guideline 2: No other network user worse off

Views of interested parties

(a) Equity

NSW Treasury is concerned that Guideline 2 has been introduced purely on equity grounds and that equity between customers is an issue for governments rather than the Commission. It states that Guideline 2 need only ensure that TNSPs do not recover more than their revenue cap in order to remain consistent with society’s expressed view on equity.

(b) Information requirements associated with Guideline 2

NSW Treasury argues that Guideline 2 requires the TNSP to make a judgement about whether the granting of a discount is likely to lead to an increase in the TNSP’s revenue cap, and if so, by what amount. It argues that, while the TNSP may be in a reasonable position to make some judgement about the effect that a certain customer not by-passing the grid may have on the utilisation of network assets, the TNSP is likely to be in a very poor position to judge what effect this higher level of utilisation will have on its revenue cap. NSW Treasury considers that only the Commission, as economic regulator of TNSPs, can have this information. It believes that to require the TNSP to satisfy Guideline 2, without having control, or indeed even having a clear idea of the Commission’s policy on asset optimisation and revaluation, is likely to create a significant financial risk for TNSPs and could deter them from offering efficient discounts.

Commission’s considerations

(a) Equity

Clearly, governments have a legitimate role in deciding matters of equity. However the National Electricity Code, which participating governments have endorsed, sets out a number of equity based objectives. In any case, Guideline 2 has a basis in efficiency as well as in equity. The general and common services charges are structured so as to minimise distortion, but will not entirely prevent it. The greater the amount of money to be recovered through these charges, the greater the likelihood that they will distort some network customers’ behaviour. Guideline 2 helps avoid that distortion by ensuring charges are no higher than they would have been had the discount not been offered.

(b) Information requirements associated with Guideline 2

The Commission notes that its Draft Regulatory Principles (DRP) indicate the Commission's proposed approach to the issues of optimisation and revaluation.⁷ Also as most TNSPs have, by now, had their revenue caps determined by the Commission they are aware of the methodology that it uses in doing so. Hence they are likely to be in a reasonable position to estimate what the likely effect of the level of utilisation of the network will have on their revenue caps. It should also be noted that the Commission is presently reviewing its policy on the issues of optimisation and revaluation. It is expected that these policy issues will be resolved before the end of 2002 and made available to TNSPs through a revised DRP.

The Commission believes that its decision to provide up-front guidance on whether or not a discount application satisfies the guidelines should also serve to alleviate, to some extent, the concerns raised by NSW Treasury in relation to this issue.

5.13 Guideline 3: Safe harbour provision

Views of interested parties

The Gladstone Economic Industry Development Board (GEIDB) submits that the safe harbour provisions contained in Guideline 3 should be restructured to recognise that in the case of industries that have a regional, state and national strategic economic benefit there is also a significant grid user and generation benefit when energy consumption exceeds 500MW. In these cases, GEIDB considers the recovery co-efficient under the guideline should be increased to 90 per cent and the absorbed co-efficient reduced to 10 per cent.

TransGrid more generally believes that consideration should be given to lowering the TNSP's contribution under Guideline 3. Powerlink notes that for large loads non-recovery of 30 per cent of the discount would be considerable lost revenue for a TNSP. Both parties consider that it would be unlikely that any TNSP would make use of Guideline 3 without at least thinking that Guidelines 1 and 2 could be satisfied at the time a discount was offered.

Powerlink seeks confirmation that Guideline 3 caps a TNSP's exposure to non-recovery of the discounted amount, should the Commission subsequently not approve recovery of the full amount of the discount from other network users.

VENCorp is concerned that the 30 per cent exposure may not always discourage TNSPs from offering inefficient discounts due to their incentive to offer them in order to bring forward network augmentation or avoid asset optimisation.

⁷ *Draft Statement of Principles for the Regulation of Electricity Transmission Revenues*, 27 May 1999, ACCC.

Commission's considerations

A key principle of the Guidelines is to ensure that cost recovery is sanctioned when, and only when, it is in the market's interest to do so. However in practice Guidelines 1 and 2 may sometimes be costly and complex to comply with. Therefore, to address this potential problem it has been decided to include a safe-harbour guideline that is simple to assess.

The Commission can confirm its intention that Guideline 3 caps a TNSP's exposure in the event that the TNSP cannot demonstrate conformance with Guidelines 1 and 2. The Commission has amended the Guidelines so that its intention is made explicit.

GEIDB contends that the TNSP's exposure cap should be reduced to 10 per cent for large projects. The Commission considers that, where a customer's investment will benefit the network and other network users, such benefits should be reflected automatically in a low customer TUOS usage charge for the load concerned. Further the effort involved in demonstrating compliance with Guidelines 1 and 2 is less likely to be prohibitive in the case of a large project. Thus it is not clear at this stage that there is any need to vary the safe-harbour ratios. The Commission also considers that issues of state, national and strategic benefit are a matter for negotiation with respective jurisdictional authorities.

The Commission recognises that the figure of 30 per cent that the TNSP is expected to absorb is necessarily a compromise. VENCORP is concerned that if set too low it may result in cost recovery being sanctioned in circumstances where it is detrimental to the market.⁸ On the other hand, TransGrid and Powerlink are concerned that if set too high it may inhibit legitimate discounting. Both are valid concerns but as yet there is insufficient information to conclude the present figure of 30 per cent is either too high or too low. The Commission therefore proposes to keep the safe-harbour ratio under review until further experience accumulates.

5.14 Guideline 4: Treatment of pre-existing discounts

The Commission's Discussion Paper only contained three draft guidelines. Guideline 4 has been introduced in the finalised Guidelines to address the following issue.

Views of interested parties

Energy Australia considers it important to make a distinction between existing and new supply arrangements. It notes that there are a limited number of transmission customers that currently receive a discount for a variety of historical reasons. Energy

⁸The prohibition on recovering usage charge discounts should help in this regard but, since the usage charges may not always accurately reflect the incremental cost of a serving a user, cross-subsidisation may still be an issue.

Australia considers that if a customer is already in receipt of a discount when measured against the basic CRNP rate, then in going forward, only if that discount were increased might other customers see an increased charge. It believes that at the time the customer's price is subject to review, it is appropriate to evaluate price movements against the existing rates.

Commission's considerations

Energy Australia's submission raises a couple of important issues regarding the treatment of cases where there is a pre-existing agreement covering a customer's transmission charges. In some cases, the pre-agreed charges may be below those that would now normally be payable. That is, the customer is effectively in receipt of a discount. Should the TNSP be permitted to recover the costs of that discount and should there be any special consideration when the arrangements are due for re-negotiation?

The Commission has addressed these issues through a fourth guideline. It considers that it is reasonable to sanction ongoing cost recovery where a price was negotiated in good faith in the past and a TNSP has been locked in contractually. However, there is no specific reason why special consideration should apply once the contract expires or scope exists to re-negotiate the pricing provisions of a particular contract. Guideline 4 is set out below:

“A TNSP may recover from other transmission customers the amount of a discount to a transmission customer's Customer TUOS general and/or common service charges:

- (a) where the discount arises as a consequence of transmission charges being based on an agreement entered into prior to 10 October 2001; and*
- (b) for so long as the agreement remains in effect and does not provide for re-negotiation of the amount of the transmission charges.”*

Approval will lapse when the TNSP is no longer locked into that discounting arrangement, for example, when the contract expires or there is provision for re-negotiation of charges under certain circumstances. Guidelines 1, 2 or 3 would then be applicable. Note that under the Code the Commission can only sanction cost recovery in the case of discounts to the general and common service charges. Where the pre-existing charge is so low as to effectively include a discount on the usage charge, that portion of the discount must be borne by the relevant TNSP.

5.15 Discount application and approval procedures

Views of interested parties

TransGrid considers that the guidelines should include information on the process for making an application to the Commission and the intended assessment process. Energy Australia also requested that the Guidelines contain more detail regarding the processes to be followed.

Commission's considerations

The Commission agrees that the Guidelines should contain greater guidance as to the process for making an application to the Commission and the intended assessment process. The Guidelines now contain greater guidance.

5.16 Network users' discount expectations and application processing costs

Views of interested parties

TransGrid notes that the discounting guidelines developed by the Commission are designed to deal with occasional distortionary impacts arising from network pricing arrangements. It therefore considers that discounting of transmission charges should only apply in limited circumstances and suggests that the Commission needs to state this view very clearly in the finalised guidelines. TransGrid states that "it would be extremely unfortunate if customers gained the impression that discounts may be widely available, as under the guidelines, there are likely to be few successful cases. TNSPs do not wish to be blamed for dashing over-inflated expectations that some network users may develop." TransGrid is also concerned that, without a clear signal from the Commission, the number of discount applications will increase even though many of these applications will fail to satisfy the guidelines. It believes that considerable time and resources may be required to process these applications.

VENCorp understands and supports the need for public disclosure, but publication may have a down-side in encouraging enquiries for discounts that are unlikely to meet the discounting guidelines. It believes that there may be some difficulties and resourcing issues in dealing with these requests for discounts and considers that, in some situations, that it would be reasonable to allow TNSPs to recover the costs associated with dealing with them. It notes that this would be similar to a TNSP's right to charge an application fee for handling connection enquiries under clause 5.3.3 of the Code.

Commission's considerations

The Commission acknowledges that publicity on successful discounts may encourage over-optimistic discount applications. On the other hand, it may help to clarify the attributes needed by applicants in order to be successful and therefore discourage over-optimistic applications. The Commission notes the concerns raised by TransGrid and VENCorp and intends to make it clear in the finalised guidelines that discounts will only be approved by the Commission if the TNSP is able to provide it with sufficient evidence that the appropriate guidelines have been fully complied with.

In terms of the impact on resourcing that discount enquiries may have, the Commission notes that clause 6.5.9(b)(8) would allow a TNSP to recover reasonable direct costs incurred in processing an application to provide negotiable services. This clause would therefore allow an application fee to be charged by a TNSP when processing a discount enquiry. The Commission therefore considers that this may have the effect of

discouraging frivolous applications and/or of ensuring that costs associated with processing such applications are not borne by others.

5.17 Robustness and clarity of the guidelines

Views of interested parties

(a) Theoretical robustness

NSW Treasury states that the guidelines must be theoretically robust, in that they must only allow efficient discounts to be recovered from other network users. That is, the discounts should not lead TNSPs to offer prices to some customers below the incremental cost of providing transmission services. NSW Treasury considers that this is already achieved without guidelines since, under the Code, TNSPs cannot recoup discounts larger than the usage charge and usage charges are intended to reflect incremental costs.

(b) Practical robustness

NSW Treasury states that the Guidelines should not impose unnecessary barriers to the provision of efficient discounts. It considers that TNSPs have limited incentives to offer discounts due to the risk that the Commission will subsequently dis-allow a discount to be recovered from other network users and from the lack of up-side benefits from giving the discount unless asset optimisation is a significant risk.

(c) Clarity

NSW Treasury states that the Commission must apply terminology carefully in the Guidelines in order to minimise the risk of misinterpretation or error. It believes that the Discussion Paper containing draft guidelines fails to provide a clear and succinct description of the TUOS discounting proposal. For example, it states that the use of the term 'cross-subsidise' on page 5 of the Discussion Paper is incorrect and that a cross-subsidy cannot, by definition, occur if the discount is restricted to the general and common services charges. NSW Treasury states that the guidelines are therefore unnecessary to ensure that a cross-subsidy does not occur. It considers that this lack of clarity will create uncertainty amongst TNSPs and network users and will hinder the effective application of the discounting arrangements.

Commission's considerations

(a) Theoretical robustness

The Commission agrees that the guidelines will not be theoretically robust if they result in some customers being offered prices below the incremental cost since this would represent cross-subsidisation and encourage inefficient utilisation of the network. However, this is only one aspect of achieving the broader efficiency objective of maximising benefits to the market as a whole.

Requiring discount beneficiaries to pay the full incremental cost that they impose on the network should prevent distortion of their behaviour through cross-subsidisation

(discount beneficiaries should then have incentives to act in ways that maximise benefits to the market as a whole). However, the benefit-maximisation objective may still be compromised if the discount results in unnecessary distortion of other stakeholders' behaviour.

Other network users' behaviour will be distorted if they see higher general charges than necessary, as they will if the discount is larger than it need be. The general charge is structured so as to minimise distortion but cannot be absolutely free of distortionary impacts. Thus, to ensure maximum benefit to the market as a whole, the discount should be no larger than necessary.

It is not clear that a TNSP will always have incentives to ensure that a discount is no larger than necessary. Consider for example a situation where a 50 per cent discount on the general and common service charges would be sufficient to avoid distortion to the beneficiary's behaviour (eg. a 50 per cent discount would be sufficient to ensure that the customer connects to the network). Suppose also that if the customer connects the TNSP will be in a good position to justify an augmentation (or alternatively to avoid optimisation). The TNSP may then be tempted to offer a full 100 per cent discount of the general and common services charges. This would ensure that the customer connected while avoiding the need for the TNSP to analyse the customer's case in detail. However, it would result in unnecessarily high charges and consequently greater distortion for other network customers.

In some situations, a TNSP may stand to profit from expanding its network if it can persuade a new customer to connect by charging less than incremental cost. The prohibition on the recovery of discounts to the usage charge provides some protection against this scenario but, as discussed below in the Commission's consideration of the clarity of the guidelines, the TNSP has some discretion in setting usage prices. Thus while agreeing that the guidelines should be theoretically robust, this implies not only that cross-subsidisation should be avoided, but also that the distortion of other network users' behaviour should be minimised.

(b) Practical robustness

Clearly it is desirable to avoid unnecessary barriers to the provision of efficient discounts. The Commission agrees that the risk of subsequent dis-allowance of the recovery of the cost of a discount from other network users may present such a barrier. One intended purpose of Guideline 3 was to minimise this risk by limiting a TNSP's down-side risk to 30 per cent of the negotiated discount.

As stated earlier, the Commission has decided to offer to review a discount at the time it is negotiated and to provide guidance to the TNSP as to whether or not it appears to satisfy the guidelines. This should significantly reduce the risks to the TNSP from offering discounts.

NSW Treasury also considers that TNSPs have limited incentives to offer discounts unless optimisation is a significant risk. The Commission notes that, in addition to the avoidance of optimisation, another benefit from providing a discount may be the expansion of a TNSP's asset base and therefore the potential for revaluation.

(c) Clarity

TransGrid is concerned that the term ‘cross-subsidy’ was not used correctly on page 5 of the Commission’s Discussion Paper. It argues that cross-subsidisation cannot occur if the discount is restricted to the general and common services charges.

The Commission agrees that charging a network user less than the incremental cost of providing a service constitutes a cross-subsidy. The usage charge is intended to reflect the incremental cost and, if this intent can be achieved in practice, a discount that is restricted to the general and/or common service charges will not result in a cross-subsidy. However, the current methodology prescribed for setting usage charges does not guarantee that the usage charge will always truly reflect the incremental cost. Moreover, the Code gives the TNSP a certain amount of discretion in setting usage charges. Therefore a TNSP who wishes to arrange a cross-subsidy may have some opportunity to do so. Thus the Code itself does not afford complete protection against cross-subsidisation. Hence it seems legitimate to consider what incentives TNSP’s might have to engineer cross-subsidies and to look at ways in which guidelines might counter those incentives.

5.18 Qualified approval of discounts

Views of interested parties

TransGrid considers that the Commission should clarify how it would deal with a situation where it accepted that a discount was appropriate but did not agree with the size of the discount. Under such circumstances TransGrid believes that it may be appropriate to offer qualified approval, where cost recovery is approved to a level the Commission considers appropriate. It believes that the Guidelines may need to be modified to ensure that such qualified approvals are possible.

Commission’s considerations

The Commission agrees that in order to enhance the administrative efficiency of the Guidelines that it should have the ability to provide a qualified approval in response to a discount application. For example, the Commission could notify the relevant TNSP(s) that it does not believe that the proposed discount complies with the guidelines but that a smaller discount of size ‘x’ would comply with them and hence is restricting approval for cost recovery to the amount of ‘x’. The Guidelines have been amended to allow the Commission to provide qualified approvals.

5.19 Status of the discussion material

Views of interested parties

TransGrid notes that the Discussion Paper contains a significant amount of material explaining the reasoning underlying the draft guidelines. Although it believes that this material is appropriate in the Discussion Paper and adds meaningful content to the document, TransGrid submits that the Commission should consider whether to include this discussion in the final version of the Guidelines. At issue is the status of the

discussion, specifically whether it is intended to be used as a guide to interpret the guidelines or not. If the discussion is to be included in the final version of the Guidelines then TransGrid believes that an indication as to the status of the discussion material in applying the Guidelines should be made.

Commission's considerations

The Discussion Paper contained a significant amount of material explaining the lines of reasoning that led to the draft guidelines. This was intended to promote discussion by enabling readers to comment on the reasoning as well as the guidelines themselves. The Commission agrees that this material is less relevant in the finalised guidelines, where the focus should be more on the guidelines themselves and procedural matters. The Commission has therefore largely removed the discussion material from the finalised guidelines.

The Discussion Paper also contained interpretative comments and examples. This material has been retained in the finalised guidelines, however, it is intended to be subordinate to the Guidelines themselves. A statement to this effect has been included in the finalised guidelines.

6. Commission's decision

The Commission has developed Guidelines for the Negotiation of Discounted Transmission Charges having regard to submissions received in response to its earlier Discussion Paper (see section 4 of this paper). The Commission has also taken into account issues arising out of the assessment of an application for cost recovery received in accordance with clause 6.5.8(c)(1) of the Code. A copy of the Guidelines appears as an annexure to this document and can also be found on the Commission's web site:

<http://www.accc.gov.au/electric/regulation.html>

In publishing the Guidelines on its website on 3 May 2002 the Commission has fulfilled its obligation under clause 6.5.8(c) of the Code. The Commission intends to monitor the application of the Guidelines and should experience show that they are not meeting their objectives the Commission may choose to review them at a later date following due consultation with relevant stakeholders.

Annex A – Guidelines for the Negotiation of Discounted Transmission Charges

Guidelines

Statement of Principles for the Regulation of Transmission Revenues

Guidelines for the Negotiation of Discounted Transmission Charges

Date: 3 May 2002

Glossary

Application	discount recovery application
Code	National Electricity Code
Commission	The Australian Competition and Consumer Commission
Discussion Paper	Draft guidelines for the Negotiation of Discounted Transmission Charges
DRP	Draft Regulatory Principles
Guidelines	Guidelines for the Negotiation of Discounted Transmission Charges
NECA	National Electricity Code Administrator Ltd
NEM	National Electricity Market
NSP	Network Service Provider
TNSP	Transmission Network Service Provider
TUOS	Transmission Use of System

Discounting Guidelines

These Guidelines comprise the ACCC's Guidelines for the Negotiation of Discounted Transmission Charges referred to in clause 6.5.8 of the National Electricity Code (Code), following the publication of this document on the Commission's website <http://www.accc.gov.au/electric/regulation.html> on 3 May 2002.

Under the Code, a Transmission Network Service Provider (TNSP) that agrees to discount a transmission customer's Transmission Use of System (TUOS) general and/or common service charges is permitted to recover from other transmission customers all or part of the amount of the reduction provided that the TNSP is satisfied that it can demonstrate that the discount complies with these Guidelines. If at the regulatory reset the TNSP does not demonstrate to the satisfaction of the Commission that the discount satisfies the Guidelines, the Commission may reduce the TNSP's revenue cap for the next regulatory control period to take into account the discount amount that has been recovered from other transmission customers during the preceding regulatory control period.

Four guidelines are included. To demonstrate compliance with the Guidelines it will be sufficient to demonstrate that a discount complies with both guidelines 1 and 2, or with guideline 3, or with guideline 4.

Some comments and examples accompany the four guidelines. This material is designed to clarify the intent of the guidelines and assist with their application. The guidelines themselves however take precedence in any matters of interpretation.

Guideline 1 – the discount is no larger than necessary

The discount offered should be no larger than that necessary to prevent the general and/or common service charges altering the beneficiary's behaviour to the point of adopting the most attractive alternative in place of the course of action the beneficiary would have adopted if no such charges were levied.

To demonstrate compliance with Guideline 1 it is sufficient for the TNSP to:

- prove that the alternative scenario/s are technically and commercially credible; and
- provide information to the Commission on the costs and benefits of the proposed course of action and the most technically and commercially attractive alternative (for example, a net present value analysis), sufficient to demonstrate that the negotiated discount is no larger than that required to prevent adoption of that alternative.

Depending on the context, an alternative scenario may for example involve by-passing parts of the network, not connecting to the network or refraining from increasing demand for electricity. See Appendix 1 for a practical example of the application of Guideline 1.

Guideline 2 – no other network users worse off.

No other network users should be worse off as a result of the discount being offered compared to the situation where the discount was not offered.

In order to comply with Guideline 2 it will be sufficient for the TNSP to demonstrate to the Commission that by offering the discount:

- (a) its revenue cap will not increase; or
- (b) that the increase in its revenue cap will be less than the increase in network charges (other than for dedicated assets) payable by the beneficiary of the discount;

relative to the situation which would prevail if the discount was not provided.

If neither of these conditions are satisfied outright, the TNSP will be required to absorb a proportion of the discount sufficient to reduce its effective revenue cap to a level at which (b) is satisfied.

See Appendix 1 for a practical example of the application of Guideline 2.

In some cases a negotiated discount may apply to only a portion of the customer's overall supply. In such situations Guidelines 1 & 2 should only be applied to that portion and not to the entire load.

Guideline 3 – Safe-harbour provision

Recovery of 70 per cent of the amount of a discount to a transmission customer's general and/or common service charges will be approved providing the TNSP has agreed to absorb the remaining 30 per cent.

Guideline 3 caps a TNSP's exposure in the event that it does not demonstrate to the Commission compliance with Guidelines 1 and 2; or with Guideline 4.

See Appendix 1 for a practical example of the application of Guideline 3.

Guideline 4 – Treatment of pre-existing discounts

A TNSP may recover from other transmission customers the amount of a discount to a transmission customer's Customer TUOS general and/or common service charges:

- (a) where the discount arises as a consequence of transmission charges being based upon an agreement entered into prior to 10 October 2001; and
- (b) for so long as the agreement remains in effect and does not provide for re-negotiation of the amount of the transmission charges.

Approval for recovering the amount of a pre-existing discount lapses when the TNSP is no longer locked into that discounting arrangement, for example when the contract expires or where a contract provision for re-negotiation of charges can be exercised

Guidelines 1 and 2; or 3 would then be applicable. It should be noted that the Code only allows the Commission to approve cost recovery in the case of discounts to the general and/or common service charges. Where the pre-existing TUOS charge is so low so as to effectively include a discount to the usage charge, then that portion of the discount relating to the usage charge must be borne by the relevant TNSP. See Appendix 1 for a practical example of the application of Guideline 4.

Regulatory process

Approval of the recovery of the amount of discounts

Clause 6.5.8(c) of the Code provides that, following the publication of the Commission's Guidelines, a TNSP may recover the amount of a discount to a transmission customer's general and/or common service charges from other transmission customers provided that the TNSP is satisfied it can demonstrate that the discount complies with those Guidelines.

Formal consideration by the Commission of the recovery of the discount is to be undertaken when next setting a revenue cap for the TNSP. Clause 6.5.8(e) provides that the Commission may, when setting a revenue cap for a TNSP, reduce the revenue cap to take into account the recovery of a discount in the preceding regulatory control period where the TNSP does not demonstrate to the Commission's satisfaction that the recovery of the discount complied with the Guidelines.

Thus the Code places the onus on the TNSP in the first instance to satisfy itself that a discount is likely to meet the guidelines. The Commission's formal assessment does not take place until the subsequent regulatory reset. Nevertheless, the Commission is prepared, on request from the TNSP, to undertake a preliminary assessment and to provide an advance indication of its likely decision. It should be noted that any such advance indication cannot constitute formal approval for recovery of the discount under clause 6.5.8(e) and does not bind the Commission in any way.

However where the Commission has indicated that, in its opinion, the recovery of a discount will comply with the Guidelines, the Commission would not anticipate departing from this opinion in its formal assessment of the discount unless:

- information provided to the Commission in forming this opinion was incorrect or further information becomes available which would have justified the Commission forming a different opinion; or
- forecasts used by the TNSP in its assessment of the discount were not made or relied on in good faith or were unreasonable;

Note: the Commission acknowledges that some disparity between forecast and actual data is inevitable. It is not the Commission's intention that this would provide grounds to depart from its opinion regarding a discount unless the disparity is so great as to suggest that the use of the forecasts by the TNSP was unreasonable. Accordingly, it is important that TNSPs exercise due care and diligence in assessing the recovery of a discount against these Guidelines and advise the Commission as soon as possible if

information provided to the Commission is found to be incorrect or if new information emerges that could justify a re-assessment of a discount.

Clause 6.5.8(e) requires the Commission to consider, at each reset, whether to reduce a revenue cap to take into account the recovery of a discount during the preceding regulatory control period. This means that, where a discount operates over more than one regulatory control period, the Commission is required under the Code to consider at each revenue reset whether the recovery of the discount was permissible. However, where the recovery of a discount has been approved by the Commission under clause 6.5.8(e) at the first reset following the negotiation of the discount, the Commission would not anticipate departing from this decision except in the circumstances outlined above. At subsequent resets, TNSPs will not have to submit additional material to demonstrate that the recovery of the discount complies with the Guidelines unless specifically requested to do so by the Commission.

It is possible that a discount negotiated in good faith may appear several months or years later, in light of new information not available at the time of the discount negotiations not to comply with the Guidelines. In undertaking its assessment of whether or not the discount complied with the Guidelines the Commission intends to rely on information that could reasonably have been available at the time of the initial discount offer. That is, that any *ex post* assessment of a discount should be conducted as if it were done at the time the discount was negotiated, subject to the above caveats.

The Commission notes that it intends to monitor the application of the Guidelines and may decide to review them at a later date after consultation with relevant stakeholders. Should the Commission alter the Guidelines between the time a discount is negotiated and the time the Commission undertakes its assessment the TNSP would have discretion as to whether or not the discount should be assessed under the Guidelines in effect at the time of negotiation of the discount or under the newly published Guidelines.

The Commission may decide to provide a TNSP with a qualified response to a discount recovery application. For example, the Commission may notify the relevant TNSP at the time of the regulatory reset that, while it does not consider that the full discount complies with the Guidelines, a smaller discount of size 'x' does comply. If an amount greater than 'x' has been recovered in the preceding regulatory control period, the Commission may decide to claw back the excess in the subsequent control period.

Similarly an advance indication, provided in response to an application received during a control period may stipulate that although the Commission is of the opinion that the full proposed discount would not satisfy the guidelines, a discount of size 'x' would appear likely to do so. The Commission notes that the formal process in the Code envisages that a TNSP will satisfy itself that a discount is likely to satisfy the Guidelines before approaching the Commission at the regulatory reset. The TNSP's assessment would be based on information supplied by the customer during the discount negotiations, information provided from independent experts and/or its own knowledge of network options and costs.

Likewise, the Commission expects that the TNSP will satisfy itself that a discount is likely to satisfy the Guidelines before seeking a letter of guidance from the

Commission. Nevertheless, the Commission is also prepared to review applications in the special circumstance where an irreconcilable difference has arisen between the customer and the TNSP as to whether the proposed discount would satisfy the Guidelines.

The assessment process

A discount recovery application (Application) from a TNSP can be provided to the Commission either during a regulatory control period or at the time of the regulatory reset.

(a) An Application submitted to the Commission during a regulatory control period.

The Application would be accepted and a preliminary assessment would be undertaken as to whether or not it satisfies the Commission's Guidelines. Should the Application be assessed as satisfying the Guidelines the Commission would provide the TNSP with a letter of guidance to this effect. The Application would be placed on file for formal assessment at the relevant TNSPs next regulatory reset. A TNSP would, however, have the option of providing a revised Application if they wished as part of their formal revenue application.

It should be noted that prior to assessing an Application during a control period the Commission would require some evidence that discount negotiations have been finalised or are at a late stage.

Should the preliminary assessment find that the discount does not comply with the Guidelines the Commission would provide the TNSP with a letter of guidance to that effect. The Commission may, where appropriate, provide an indication to the TNSP that a portion of the submitted discount might be considered as satisfying the Guidelines.

(b) An Application submitted to the Commission at the time of a TNSP's regulatory reset.

The Application would be accepted and assessed as part of the TNSP's revenue determination. It is expected that the Application would be provided to the Commission as part of a confidential attachment to a TNSP's formal revenue application. As part of its revenue determination the Commission would advise the TNSP as to whether or not the submitted discount wholly or partially satisfies the Guidelines. Should the discount not fully comply then there is a possibility that the Commission may 'claw back' the non-complying part of the discount from the TNSP through a reduction in its revenue cap. The Commission considers that it may be useful, either before or after making a formal application, for a TNSP to arrange a meeting with the Commission to present its Application. Similarly, the Commission may request a meeting with a TNSP to clarify aspects of an Application. Attendance of beneficiary representatives would be permissible with the agreement of the TNSP(s).

For an Application received during the regulatory control period the Commission requires a period of 40 business days to assess and provide guidance as to whether or not it is likely to satisfy the Guidelines. However, should further information be

required to assess the Application, this period would be extended by the time taken to obtain the additional information. An Application received, as part of a TNSP's revenue application will be processed in the time allocated for the Commission to make its revenue determination.

The Guidelines do not place a limit on the term of any negotiated discount as this is a matter for the discounting parties. However, the Commission does intend to assess more rigorously discounts of a longer term than those of a shorter duration.

On occasions a network user may need to negotiate a discount with more than one TNSP. The Commission considers that it is in all parties interests for initial discount negotiations to involve all parties (utilising the negotiating framework referred to in Code clause 6.5.9) and for a joint application or at least concurrent applications to be made to the Commission for approval of cost recovery. However, the Code clearly provides for the transmission customer to negotiate separately with each TNSP if it so wishes. As such the Commission considers that it should be left to the customer's discretion as to how to proceed.

As discussed below it is important that an Application outline the method the TNSP has chosen to calculate the amount to be recovered from other transmission customers in each financial year for the term of the discount. The Commission's approval will refer to this method and may specify an alternative or modified method if considered appropriate.

The discount recovery application

An Application from a TNSP to the Commission for the recovery of the amount of a discount from other network users must contain the following information as a minimum:

- identification of the TNSP(s) seeking to recover the amount of the discount (for example, company name, ACN, address for correspondence; and trading name (if different from company name));
- the name of a contact officer within the TNSP(s) and their contact details;
- the name of the beneficiary of the negotiated discount;
- a description of the discount, including:
 - which charge(s) the TNSP(s) propose to discount;
 - the term of the discount;
 - the proportion of the discount for which cost recovery approval is sought;
 - the method for calculating the amount to be recovered from other transmission customers in each financial year for the term of the discount;
 - the date of the commencement of the discount;
 - the nominated guideline(s) under which approval is being sought (that is, either Guideline 1 & 2; or 3; or 4 or some combination of them); and

- the type of Application being made (that is, either single, joint or concurrent). If a concurrent Application is being made then reference to the related application(s).
- for an Application made during a regulatory control period evidence that discount negotiations have been finalised or are at a late stage;
- supporting material sufficient to enable meaningful assessment of the discount. Should the material provided be inadequate for the Commission to undertake meaningful assessment then there is a possibility that the processing of the request for cost recovery could be delayed; and
- the authorised signatories (including name(s), position(s), signature(s) and date signed).

Requirement to publish aggregate discount information

The Commission's considers that, in instances where negotiated discounts are to be recovered from other network users, these users have a right to know the amounts involved. Clause 6.2.5 of the Code requires a TNSP in each instance, as part of the annual compliance statement process, to provide information to the Commission regarding each discount negotiated in a financial year. In doing so the TNSP must substantiate any claim that the discounting information is of a confidential nature. This information may then be used by the Commission to publish aggregate information on the dollar amount of discounts provided by a TNSP and the percentage of the discounts recovered from other transmission customers in that financial year.

The Commission intends to publish annually aggregate information on the discounts offered and the proportion of those amounts to be recovered from other network users. In doing so the Commission undertakes to maintain the confidentiality of any commercially sensitive information provided to it. It intends to do this by aggregating the information to such a level so that the confidentiality of the information is maintained.

Appendix 1: Applying the discounting guidelines

Example I – Application of guidelines 1, 2 and 3

Description

An entrepreneur plans to establish a factory that will consume 100 MW on a continuous basis. The factory's size and location are dictated by factors unrelated to electricity supply but on-site generation is a credible alternative to taking supply through the grid.

The transmission prices that would normally apply at the connection point are:

Usage: \$6/MWh in business hours (2000 hours per year) and zero at other times

General: \$5/MWh applied to energy consumed during relevant year or \$30,000/MW applied to connection capacity (whichever results in the lower charge).

Common service: \$1/MWh or \$6,000/MW, applied in same way as the general price.

However the customer has negotiated a 40% discount on the general price, reducing it to \$3/MWh or \$18,000/MW.

If the customer connects it pays \$200,000 per year for its dedicated connection assets (of which \$20,000 is assumed to be profit for the TNSP).

Other relevant facts are:

- the price of energy at the customer's connection point would be \$30/MWh;
- the annualised cost of on-site generation would be \$40/MWh;
- if the customer installed on-site generation it could sell 50 MW of by-product heat at \$10/MWh;
- the on-site generating equipment would be out of service for five days per year and the customer would either have to purchase standby energy from the grid or shut down production during that period; and
- profits forgone while production was shut down would be \$20,000 per day.

The TNSP is seeking approval to recover the full cost of the discount from other network users. The TNSP must demonstrate that Guidelines 1 and 2 are both satisfied, that is:

1. *The discount is no larger than necessary* – The discount offered should be no larger than that necessary to prevent the general and common service charges altering the beneficiary's behaviour to the point of adopting the most attractive alternative in place of the course of action the beneficiary would have adopted if no such charges were levied.

2. *No other network users worse off* – no other network users should be worse off as a result of the discount being offered compared to the situation where the discount was not offered.

The following sections illustrate how the TNSP might demonstrate conformance with these guidelines.

Guideline 1: the discount is no larger than necessary

The assessment involves comparing the costs and benefits that accrue to the customer if it receives the discount and proceeds with its preferred option ('the discounted network option') with those that would accrue under the most attractive alternative option ('the credible alternative'). To satisfy guideline 1, the discount will need to be no larger than is necessary to ensure the discounted network option is more attractive to the customer than the credible alternative.

Credible alternatives

Two alternative scenarios will be considered:

1. install generating equipment on-site, but connect to network so as to be able to obtain stand-by supply when on-site equipment is out of service (about 5 days per year); and
2. install generating equipment on-site, but instead of connecting to network stop production when on-site generating equipment is out of service.

Comparison of costs and benefits to customer

Costs and benefits accruing to the customer under the discounted network option and these two credible alternatives are summarised in Table 1. Only those costs and benefits that are scenario-dependent have been considered, since costs that are common to all scenarios have no impact on their ranking.

Discussion

From Table 1, it is evident that the discounted network option is the most attractive, given the proposed discount. Complete reliance on embedded generation (credible alternative #2) is the next most attractive option at that level of discount. Thus the proposed discount is large enough to ensure the discounted network option is the most attractive one for the customer, but is it significantly larger than it needs to be to achieve that? It results in the discounted network option being the most attractive by a margin of \$260,000 per year. On the face of it, the proposed discount is not significantly larger than necessary to achieve its purpose.

Table 1. Costs and benefits accruing to the customer.

Scenario	Item	Annualised benefit	
		(amounts in 2002 dollars; negative values parenthesised)	
Discounted network option (Note 1)	electrical energy	100 MW x 24 h x 365 days x \$30/MWh	= (26,280,000)
	usage charge	100 MW x 2000 h x \$6/MWh	= (1,200,000)
	general charge	100 MW x \$18,000/MW	= (1,800,000)
	common service	100 MW x \$6,000/MW	= (600,000)
	connection services	\$200,000/year	= (200,000)
	TOTAL for discount network option		
Credible alternative #1 (Note 2)	electrical energy	100 MW x 24 h x 5 days x \$30/MWh	= (360,000)
	usage charge	100 MW x 30 h x \$6/MWh (Note 3)	= (18,000)
	general charge	100 MW x 24 h x 5 days x \$5/MWh	= (60,000)
	common service charge	100 MW x 24 h x 5 days x \$1/MWh	(12,000)
	connection services	\$200,000/year	= (200,000)
	generation costs	100 MW x 24 h x 360 days x \$40/MWh	= (34,560,000)
	sale of process heat	50 MW x 24 h x 360 days x \$10/MWh	= 4,320,000
	TOTAL for credible alternative #1		
Credible alternative #2	generation costs	100 MW x 24 h x 360 days x \$40/MWh	= (34,560,000)
	sale of process heat	50 MW x 24 h x 360 days x \$10/MWh	= 4,320,000
	forgone production profits	\$20,000/day x 5 days	= (100,000)
	TOTAL for credible alternative #2		

Notes on Table 1

1. The capacity-based form of the general price and common service price has been used for the purpose of estimating charges under the discounted network option as this form leads to the lowest charge when a continuous 100 MW is taken from the grid.
2. Conversely, the energy-based form has been used for estimating charges under credible alternative #1 as that form leads to the lowest charges when supply is taken from the grid for 5 days per year.
3. For the purpose of estimating usage charges under credible alternative #1, it has been assumed that of the five days per year when supply is taken from the grid, 30 hours fall within peak periods when a non-zero usage price applies.

However this conclusion is quite sensitive to the data used in the analysis and in practice the Commission might require the TNSP to provide supplementary information. For example, if the cost of energy in the NEM was a little lower than assumed or the cost of on-site generation was a little higher, the alternative options would be less attractive and the discount might no longer appear justifiable.

It should also be noted that other costs and benefits exist that have not been considered in detail. For example, by bypassing the network a transmission customer could avoid paying market fees and TUOS charges. However, on the other hand the opportunity cost of utilising available easements may need to be considered as part of any bypass option. Such costs and benefits should be included where they are considered material.

Guideline 2: no other network users worse off

Does the TNSP stand to benefit?

The first step in deciding whether other users will be worse off is to determine whether the TNSP is likely to benefit. If no benefit flows to the TNSP, it is assumed that the benefits⁹ flow to other network users who are therefore, as a group, better off than if the discount had not been offered.

It is evident from the analysis for Guideline 1 that if the discount is not provided, the customer will elect not to connect to the network at all. The TNSP will then forgo the \$200,000 per year that would have arisen from the dedicated connection assets, of which \$20,000 would have been profit.

It is assumed that if the customer does not connect, the revenue requirement of under-utilised shared assets will be reduced by \$2,500,000 per year, due to a revision of the depreciated optimised replacement cost. If the customer connects, the increased utilisation is sufficient to avoid this devaluation.

Thus, the TNSP stands to benefit by \$2,520,000 per year through offering the discount. It is therefore necessary to proceed to the next step of assessing whether other network users will pay more than if the discount was not offered and the customer did not connect.

Given that the TNSP benefits, will other network users be worse off?

Under the discounted network option, the discount beneficiary will contribute \$3,600,000 per year in usage, general and common service charges (see Table 1). If the discount was not offered and the customer did not connect to the network that contribution would be absent. In addition, as a result of the customer not connecting to the network, the amount of revenue to be recovered by the TNSP would be reduced by \$2,500,000 per year due to asset devaluation. The net result is that, under the discounted network option, even if other customers bear the whole cost of the discount

⁹ Provided the discount is no larger than necessary (ie it satisfies Guideline 1) it should be safe to assume it delivers a net positive benefit to the market.

they will be paying approximately \$1,100,000 less per year than they would if no discount was offered.

Discussion

On the face of it, the other network users as a group are better off than if the discount had not been offered. Under the Guidelines, the TNSP should therefore be permitted to recover the full cost of the discount.

This conclusion appears reasonably robust to the assumptions made in the analysis. For example, the TNSP's exposure would need to be at least \$1,100,000 higher than the assumed \$2,500,000 per year before it would be required to bear a portion of the discount.

Guideline 3: Safe-harbour provision

As an alternative to demonstrating conformance to Guidelines 1 and 2, the TNSP can elect to absorb 30% of the discount, in which case it will satisfy Guideline 3 and will automatically receive approval to recover the remaining 70%.

The projected annual discount is the difference between the general charge the customer would pay under the discount network option if exposed to the full general price (\$30,000/MW), and the charge it will pay on the basis of the discounted price (\$18,000/MW):

$$\begin{aligned} \text{Annual amount of discount} &= (\$30,000/\text{MW} - \$18,000/\text{MW}) \times 100 \text{ MW} \\ &= \$1,200,000 \text{ per year} \end{aligned}$$

Thus providing the TNSP agrees to absorb \$360,000 per year (30% of \$1,200,000) it will automatically receive approval to recover the remaining \$840,000 per year from other network users.

Conclusion

The discount appears to satisfy Guidelines 1 and 2, leading to the provisional conclusion that the TNSP should be allowed to recover the full amount from other network users. However that conclusion is quite sensitive to some of the data used in the analysis. In practice, the Commission may require further information on the most critical assumptions before arriving at a final decision. In any event, the TNSP's maximum exposure to the discount will be \$360,000/year, since if it agrees to absorb that amount it satisfies Guideline 3.

Information to be published in relation to the example

The Commission intends to publish aggregate information on the amount of any discounts to general and/or common service charges in each financial year and the percentage to be recovered from other transmission customers. These statistics will be aggregated sufficiently to preserve beneficiaries' confidentiality.

In the present example, the relevant amounts would be as follows:

The discount to the general charge in any one year will be the difference between the charge actually paid by the customer and the charge that would have been payable if the general price had not been discounted. Assume for example, the customer's connection capacity is 100 MW and the consumer consumes at that rate more or less constantly throughout the year in question. Assume also that the full general price remains at \$30,000/MW while the discounted price is \$18,000/MW. Then the discount in that year will be $(\$30,000/\text{MW} - \$18,000/\text{MW}) * 100 \text{ MW} = \$1,200,000/\text{year}$.

Each financial year the relevant TNSP is required to report to the Commission the actual amount of each discount and the amount of that discount it recovered from other transmission customers in accordance with clause 6.2.5 of the Code.

Before publishing, the Commission will aggregate this information with that relating to other discounts so as to preserve beneficiary anonymity. If three or more discounts are active for the TNSP in that financial year, aggregation to the TNSP level should suffice. If not, aggregation to a higher level may be necessary. For example, the statistics may be reported at a jurisdictional level or higher if necessary.

Example II - Application of guideline 4

Description

Under an arrangement negotiated prior to 10 October 2001, a customer pays an agreed price of \$3/MWh for use of the shared transmission network. The contract contains a provision for renegotiation of this price in the event the customer's annual consumption changes by more than 30% from its normal value of 1500 GWh/year. The contract expires on 30 June 2009. The customer's agreed connection capacity is 200 MW.

The customer's transmission charge, calculated on the basis of the agreed price of \$3/MWh is normally \$4,500,000 per year. In most years this turns out to be less than the full charge that would be payable if the full usage, general and common service prices applied. That is, the customer is in receipt of a discount in most years. The TNSP therefore applies to the Commission for permission to recover the amount of the discount from other network users, in accordance with guideline 4.

Assessment

It will be assumed the TNSP submits adequate evidence (eg a certified copy of the agreement with the customer) to demonstrate to the Commission's satisfaction that the TNSP is indeed locked into the arrangement until either the agreement expires or the customer varies its consumption by more than 30%. The Commission therefore approves the TNSP's application to recover the amount of the effective discount to the general and/or common service charges, subject to the conditions that the TNSP remains unable to activate the renegotiation clause and that the agreement's expiry date has not been reached.

Financial effect

Suppose that over the next few years transmission prices at the customer's connection point follow the trajectory shown in Table 2, below. Usage prices are postulated to be rising steeply, reflecting increasing local congestion in the transmission network. There is some offsetting decrease in general charges.

The resultant size of the discount in each year and the amount approved for recovery from other users are also shown in Table 2. Initially the full amount of the discount is recoverable. However by 2005/06, the normal usage charge has risen to a level where it exceeds the agreed charge payable by the customer. The customer is now receiving a discount of \$1,500,000 on its usage charge as well as a 100% discount on its general and common service charges. The discount on the usage charge is not recoverable from other network users and must be borne by the TNSP.

Table 2 illustrates events up until 30 June 2006. Suppose for the sake of this example that in July 2006, the customer decommissions half its plant, resulting in a 50% reduction in its consumption. As a result, the renegotiation clause in its agreement can be invoked by the TNSP. Permission to recover the amount of the discount under guideline 4 therefore lapses.

Following negotiation of revised transmission charges with the customer, the TNSP may consider it has a case to recover the new discount amount under guidelines 1 and 2, and as a minimum will be entitled to recover 70% in accordance with guideline 3. However this will not be explored any further here.

Table 2

Year	Transmission Prices			Charges payable in the absence of discount (\$000/year)			discount (\$000/y) (note 4)	recoverable amount (\$000/y) (note 5)
	Usage \$/MWh (note 1)	General \$/MW (note 2)	Cmn \$/MW (note 2)	Usage (note 3)	General	Cmn		
2002/03	7	20,000	5,000	2,100	4,000	1,000	2,600	2,600
2003/04	10	17,500	5,000	3,000	3,500	1,000	3,000	3,000
2004/05	15	15,000	5,000	4,500	3,000	1,000	4,000	4,000
2005/06	20	10,000	5,000	6,000	2,000	1,000	4,500	3,000

Notes

1. Usage price is assumed to apply to consumption during on-peak times, assumed in aggregate to be 2000 hours per year.

2. The general and common service prices apply to agreed connection capacity. (It is assumed that the customer's load factor is sufficiently high to warrant a capacity-based charge instead of an energy-based one.)
3. The usage charges have been calculated on the assumption that consumption during the relevant 2000 hours per year totals 300 GWh.
4. The annual discount is calculated by subtracting the charge actually paid by the customer (\$4,500,000 p.a.) from the sum of the usage, general and common service charges that would be payable in the absence of a discount.
5. The amount recoverable from other customers equals the discount unless the discount exceeds the sum of the general and common service charges that would normally be payable.