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08th October 2010

Our Reference: UE-SU-01

Mr John Pierce
Chairman
Australian Energy Market Commission
P.O. Box A2449
Sydney South NSW 1235

BY EMAIL TO: aemc@aemc.gov.au

(And through the electronic lodgement facility)

Dear Mr Pierce,

UED submission on proposed Rule for recovery of transmission related charges on behalf of the Victorian Distribution Network Service Providers: ERC0114

UED (on behalf of the Victorian electricity distribution network service providers) welcomes the opportunity to make a submission in response to the Australian Energy Market Commission's consultation paper on the proposed Rule change relating to the recovery of transmission-related charges.

The submission by the Victorian electricity distributors is appended to this letter.

Should you have any queries in relation to the issues discussed in this response please contact Jeremy Rothfield, Regulatory Economist, on (03) 8540 7808.

Yours sincerely

Andrew Schille
Regulatory Manager

Victorian DNSPs' response to AEMC consultation paper on recovery of transmission-related charges (rule 6.18.7)

Prepared jointly by the
Victorian Electricity Distribution Businesses

8 October 2010



Victorian DNSPs response to AEMC consultation paper on recovery of transmission-related charges (rule 6.18.7)

1 Background and introduction

The Victorian DNSPs emphasise that the proposed rule change seeks to do no more than to clarify and to make explicit what is required to be included in the annual pricing proposal process. The proposed rule change goes no further than current regulatory practice in relation to the pass through of what are considered to be “transmission-related” costs. To demonstrate this, section 1.1 describes current regulatory practice in Victoria under the Electricity Distribution Price Review 2006 to 2010. Section 0 describes the AER’s current regulatory practice as it is applied in NSW, Queensland and South Australia.

1.1 Current regulatory practice in Victoria

Under the current arrangements in Victoria, DNSPs are required to submit proposed “transmission tariffs”.¹ The term “transmission tariffs” is defined to mean: “the tariffs for *transmission services* which recover those costs defined in the Maximum Transmission Revenue formula in clause 3.3.2(i)”. The term “transmission services” is defined to mean: “connection to, and use of, the *transmission system*”.

The costs defined in the Maximum Transmission Revenue (**MTR**) formula are set out in the table below.

Maximum Transmission Revenue (MTR _t)		Where represented in proposed rule change
$MTR_t = TC_t + G_t - D_t - K_t$		
MTR _t	Is the maximum revenue the distribution business is allowed to receive from its transmission tariffs from all distribution customers for the calendar year <i>t</i>	N/A
TC _t	Is the aggregate of all charges for connection to and use of the transmission system which the distribution business forecasts it will be required to pay to VENCORP and SPI PowerNet, or any other party holding a Victorian electricity transmission licence, during calendar year <i>t</i> , where payments comply with any relevant guidance in force from time to time	Clause 6.18.7(a)(1): Charges for “transmission services”
G _t	Is the amount the distribution business expects to pay embedded generators during calendar year <i>t</i> , where the payments have been verified as compliant by the Commission	Clause 6.18.7(a)(3): “avoided Customer TUOS charges”
D _t	Is the revenue which the distribution business forecasts that it will earn during calendar year <i>t</i> from other distribution businesses, in respect of inter-network provider distribution service tariffs net of similar charges which the distribution business expects to pay to other distribution businesses during calendar year <i>t</i>	Clause 6.18.7(a)(2): Charges for “distribution services provided by other Distribution Network Service Providers, net of distribution services provided to other Distribution Network Service Providers”
K _t	Is determined in accordance with clause 3.3.3 (being a correction factor to account for any under or over	Clause 6.18.7(b) and (c)

¹ ESC, *Electricity Distribution Price Review 2006-10: Final Decision Volume 2*, December 2008 (EDPR Final Decision), p 29.

Maximum Transmission Revenue (MTR _t)		Where represented in proposed rule change
	recovery of actual transmission revenue in relation to allowed transmission revenue)	

The rule change proposed by the Victorian DNSPs does not go any further than making explicit the charges that the Victorian DNSPs currently pass through in the Maximum Transmission Revenue formula. As discussed in section 1.2 below, the rule change proposed by the Victorian DNSPs is consistent with current regulatory practice in relation to the pass through of what are considered to be “transmission-related” charges.

1.2 Current regulatory practice in other jurisdictions

In distribution determinations applying in NSW, Queensland and South Australia, the AER has provided for the annual pricing proposals submitted by the relevant DNSPs to cover: Transmission charges to be paid to TNSPs; avoided TUOS payments; and inter-DNSP payments.² The AER has also approved annual pricing proposals that propose tariffs that provide for the recovery of these elements.³

AER approved categories of costs to be represented in annual pricing proposal process for NSW, Queensland and SA	Where represented in proposed rule change
Transmission charges to be paid to TNSPs	Clause 6.18.7(a)(1): Charges for “transmission services”
Avoided TUOS payments	Clause 6.18.7(a)(3): “avoided Customer TUOS charges”
Inter-DNSP payments	Clause 6.18.7(a)(2): Charges for “distribution services provided by other Distribution Network Service Providers, net of distribution services provided to other Distribution Network Service Providers”

The remainder of this submission addresses the questions raised in the AEMC’s consultation paper.

2 What charges should be recoverable?

The Victorian DNSPs submit that all transmission service charges should be recoverable, and that it is appropriate that the annual pricing proposals submitted by DNSPs provide for tariffs designed to pass on to customers these transmission service charges. This includes charges for prescribed transmission services, negotiated transmission services and unregulated transmission services.

² AER, *New South Wales Distribution Determination 2009-10 to 2013-14: Final Decision*, 28 April 2009, Appendix I, p 462 – 463; AER, *Queensland Distribution Determination 2010 – 11 to 2014 – 15: Final Decision*, May 2010, Appendix E, pp 395 – 396; AER, *South Australia Distribution Determination 2010 – 11 to 2014 – 15: Final Decision*, May 2010, Appendix F, pp 322 – 323.

³ AER approval of Country Energy pricing proposal for 1 July 2010 to 30 June 2011 at <http://www.aer.gov.au/content/index.phtml/itemId/736529>; AER approval of Integral Energy pricing proposal for 1 July 2010 to 30 June 2011 at <http://www.aer.gov.au/content/index.phtml/itemId/736532>; AER approval of EnergyAustralia pricing proposal for 1 July 2010 to 30 June 2011 at <http://www.aer.gov.au/content/index.phtml/itemId/736530>; AER approval of Energex pricing proposal for 1 July 2010 to 30 June 2011 at <http://www.aer.gov.au/content/index.phtml/itemId/736721>; AER approval of Ergon Energy pricing proposal for 1 July 2010 to 30 June 2011 at <http://www.aer.gov.au/content/index.phtml/itemId/736724>; AER approval of ETSA Utilities pricing proposal for 1 July 2010 to 30 June 2011 at <http://www.aer.gov.au/content/index.phtml/itemId/736861>.

Further, the Victorian DNSPs submit that those charges that are, according to current regulatory practice, classified as “transmission-related” charges should also be recoverable and that it is appropriate that the annual pricing proposals submitted by DNSPs also provide for tariffs designed to pass on to customers these transmission-related charges. These charges are those associated with: distribution services provided by DNSPs to other DNSPs (sometimes referred to as “inter-DNSP” or “inter-distributor” payments); and avoided TUOS payments.

The Victorian DNSPs have also identified a further charge that would be most efficiently recovered through the annual pricing proposal process, being charges for network support agreements. This is further discussed in section 2.7 below.

2.1 Should the current definition for ‘transmission services’ under the NER apply?

The Victorian DNSPs submit that the current definition for “transmission services” under the Rules should apply and that charges associated with transmission services should be represented in the tariffs submitted as part of the annual pricing proposal process. The term “transmission services” is defined to mean: “The services provided by means of, or in connection with, a *transmission system*”. The term “transmission system” is in turn defined as: “A *transmission network*, together with the *connection assets* associated with the *transmission network*, which is connected to another *transmission or distribution system*”.

There can be no dispute that to the extent that DNSPs incur transmission service charges in the provision of direct control services, then these charges should be passed on to customers and recovered by DNSPs. This is consistent with the national electricity objective in section 7 of the National Electricity Law which provides:

“The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to—

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.”

To the extent that DNSPs incur transmission service charges in the provision of direct control services and the DNSP is unable to recover these charges from its customers, then this will not promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers. This is because DNSPs will not be able to recover the prudent and efficient costs of providing direct control services.

That DNSPs should be able to recover transmission service charges incurred in the provision of direct control services is also consistent with the revenue and pricing principles in section 7A of the National Electricity Law. Of particular relevance is the revenue and pricing principle which provides that a regulated network service provider should be provided with a reasonable opportunity to recover at least the efficient costs which the operator incurs in providing direct control network services.

Using the term “transmission services” is also consistent with the provision in the Rules that requires DNSPs to pay to transmission service charges to TNSPs. Clause 6.20.1(d) provides:

“*Distribution Network Service Providers* must:

- (1) calculate *transmission service charges* and *distribution service charges* for all *connection points* in their *distribution network*; and
- (2) pay to *Transmission Network Service Providers* the *transmission service charges* incurred in respect of use of a *transmission network* at each *connection point* on the relevant *transmission network*.”

Clause 6.20.1(d) does not distinguish between whether the “transmission service charges”⁴ are prescribed, negotiated or unregulated transmission services.

2.2 If so, what would be ‘charges’ for transmission services?

The ‘charges’ for transmission services would be charges levied on DNSPs by TNSPs for use of, and connection to, the transmission system.

2.3 Should these charges only include charges for prescribed transmission services that TNSPs impose on DNSPs (that is, the prescribed exit charge, the prescribed TUOS charge, and the prescribed common charge, which are determined under Chapter 6A of the NER)?

The Victorian DNSPs submit that the charges to be included in the annual pricing proposal process should not be limited to charges for prescribed transmission services. It is possible that negotiated transmission services or unregulated transmission services may be inputs to standard control services.

It is clearly the position of AEMO that negotiated services can be inputs to standard control services. In its response to the AEMC’s review of the National Framework for Distribution Network Planning and Expansion, AEMO submitted:

“New terminal stations, or upgrades to existing terminal stations, typically result in augmentations to both the shared transmission network and connection assets. While the Rules deem connections between TNSPs and DNSPs to provide prescribed transmission services, the same does not apply to shared network augmentations resulting from a new or modified connection. These are more likely to provide negotiated transmission services as referred to in Chapter 5 of the Rules.”⁵

AEMO goes on to say that if the investment option is the one that has the greatest net benefit, then it is appropriate for the costs associated with the investment to be passed onto all consumers in the TNSP’s region.

“AEMO considers that, if an investment that spans both networks is the investment option that has the greatest net benefit when a probabilistic planning approach is applied, then the associated costs may appropriately be passed onto all consumers in the TNSP’s region. This is because this is the option that provides the maximum net economic benefit to the market, and so should be paid for by the market.”⁶

Charges for prescribed transmission services and negotiated transmission services are subject to regulatory oversight via Part C and Part D of Chapter 6A of the Rules respectively.

In relation to non-regulated transmission services (being transmission services that are neither prescribed nor negotiated transmission services), the relevant oversight or discipline on the charges associated with such services takes the form of a competitive market discipline. Non-regulated transmission services are not regulated under Chapter 6A.⁷ Clause 6A.30.5(e) provides that a commercial arbitrator must terminate an arbitration without making a decision if the arbitrator determines that the transmission service is capable of being provided on a “genuinely competitive basis” by a person other than the TNSP or by an entity which is associated with the provider. Services that are capable of being provided on a genuinely competitive basis are non-regulated transmission services.

⁴ Note that the term “transmission service charges” is italicised in clause 6.20.1(d) however only the term “transmission service” is a defined term, and the term “transmission service charges” and the term “charges” are not defined terms.

⁵ AEMO, *Re Review of the National Framework for Distribution Network Planning and Expansion (Draft Report)*, 13 August 2009, p 2.

⁶ AEMO, *Re Review of the National Framework for Distribution Network Planning and Expansion (Draft Report)*, 13 August 2009, pp 2 – 3.

⁷ See clause 6A.1.1(j).

Where a DNSP seeks to take advantage of such services, where these services are more cost effective than the alternative prescribed transmission service solution, the DNSP will negotiate a charge for such services directly with the unregulated transmission service provider.

2.4 As connection services are defined under the NER as prescribed transmission services, do charges for prescribed transmission services capture all connection costs?

Charges for prescribed transmission services are likely to capture all connection costs that are directly associated with connections between the networks of a TNSP and a DNSP. However, and as noted in section 2.3 above, it is possible that a difference of opinion could exist as to whether any augmentation required to the transmission network to facilitate the connection is to be properly characterised as a prescribed transmission service or a negotiated transmission service.

Pursuant to section 50C of the National Electricity Law and section 32 of the *National Electricity (Victoria) Act 2005* (Vic), in Victoria the functions of AEMO include, amongst other things: to plan, authorise, contract for, and direct, augmentation of the Victorian transmission network; and to provide shared transmission services by means of, or in connection with, the Victorian transmission network. Therefore, AEMO's approach in relation to shared network augmentations resulting from a new or modified connection is of more direct importance to the Victorian DNSPs, but is also of potential relevance to DNSPs more generally if the AER agrees with AEMO's approach.

AEMO's position is that shared network augmentations resulting from a new or modified connection are more likely to provide negotiated transmission services, as opposed to prescribed transmission services. Particularly in light of AEMO's position it is important that the proposed Rule change is not restricted to prescribed transmission services. To the extent that negotiated or unregulated transmission services are inputs to the provision of direct control services, tariffs in a pricing proposal should provide for the recovery of charges associated with these services. This approach is also consistent with clause 6.20.1(d) of the Rules, as discussed in section 2.1 above.

2.5 Are there other transmission-related charges that DNSPs incur in providing standard control services?

According to regulatory practice, the following charges or costs are typically characterised as "transmission-related" charges or costs that are most appropriately recovered via what may be referred to as the "transmission pass-through arrangements":

- transmission charges paid to TNSPs for use of the transmission system (use of system and connection charges);
- avoided TUOS payments made to embedded generators; and
- payments to other DNSPs for use of their network (inter-DNSP or inter-distributor payments).⁸

The proposed rule change covers these "transmission-related" charges. The Victorian DNSPs have also identified a further category of charges that would be appropriately dealt with through the annual pricing proposal process, being charges incurred under network support agreements. This category of charges is discussed in section 2.7 below.

2.6 How should 'inter-DNSP' payments be defined?

The Victorian DNSPs do not consider it necessary or desirable that the term "inter-DNSP payments" be a defined term. This term is not used in the proposed rule change. The proposed rule change

⁸ See the categories of charges identified by the AER in the example calculation of TUOS overs and unders account in: AER, *New South Wales Distribution Determination 2009-10 to 2013-14: Final Decision*, 28 April 2009, Appendix I, p 462 – 463; AER, *Queensland Distribution Determination 2010 – 11 to 2014 – 15: Final Decision*, May 2010, Appendix E, pp 395 – 396; AER, *South Australia Distribution Determination 2010 – 11 to 2014 – 15: Final Decision*, May 2010, Appendix F, pp 322 – 323. See also: IPART, *NSW Electricity Distribution Pricing 2004/05 to 2008/09: Final Report*, June 2004, pp 4, 11, 12, 21, 141 – 145; and EDPR Final Decision, Attachment 12, p 122.

refers to charges for “*distribution services provided by other Distribution Network Service Providers, net of distribution services provided to other Distribution Network Service Providers*”.

DNSPs may use other distributors’ systems to transfer electricity in their network. A DNSP could make inter-distributor payments to another DNSP for carriage of electricity on behalf of its customers and could receive inter-distributor revenue (receipts) for providing a similar service for other DNSPs.

There is a difference between at least NSW and Victoria in terms of how inter-distributor payments are dealt with. In NSW the price that a DNSP charges for conveying electricity for another distributor is part of the conveying DNSPs weighted average price cap on DUOS tariffs and is not incorporated in the transmission arrangements. IPART describes the arrangements that have applied (and are understood to continue to be applied by NSW DNSPs) as follows:

“Inter-distributor transfer (IDT) payments are made by one DNSP to another DNSP, operating in NSW or in another state, for conveying electricity through its distribution network. The Tribunal has included the costs of inter-distributor payments in the transmission recovery arrangements, as they are essentially payments to another service provider for delivering electricity to a DNSP’s network. It makes little difference whether the electricity is delivered to the DNSP via another DNSP or a TNSP.

However, any *revenue* a DNSP receives from another DNSP for inter-distributor transfers will be treated as a revenue item in the weighted average price cap. This arrangement is similar to that in the 1999 regulatory period. There is little in-principle difference in receiving revenue from retailers or from other DNSPs – in both cases, payment is for carrying electricity to supply the other parties’ customers.”⁹

It is apparent from existing practice that inter-DNSP payments may encompass a relatively wide-range of distribution services that may be provided by one DNSP to another DNSP. For example, in its most recently approved annual pricing proposal, the tariffs proposed by Energex provided for the recovery of payments to Country Energy for the supply from its Terranora substation. The Energex pricing proposal notes:

“9.1.3 Payments to other DNSPs

In contingency circumstances, Country Energy provides supply from its Terranora Substation in northern NSW to ENERGEX’s Kirra Zone Substation. Under this arrangement, Country Energy requires ENERGEX to pay for the use of its assets.

The charges established by Country Energy in respect of this arrangement are based on approved rates for each months in which the alternate supply is utilised. Based on these charges, it is expected the total estimated charges for Country Energy in 2010-11 will amount to \$360,000. These costs have been incorporated into the TUOS costs for the Mudgeeraba TNCP and therefore result in the charges from the use of Country Energy network being passed through to users.”¹⁰

Ergon Energy describes the Inter-DNSP payments that it incorporated into its most recently approved pricing proposal as follows:

“2.2.7.2 Network Charges from Other DNSPs

In the Toowoomba area, Ergon Energy takes network services from the other Queensland DNSP, ENERGEX, to supply a small group of customers that cannot be economically supplied from the Ergon Energy distribution system. ENERGEX bills Ergon Energy a network service charge for these network services. Additionally in the Mount Isa zone, Ergon Energy is charged for the use of the unregulated 220kV network which supplies the Cloncurry township.

⁹ IPART, *NSW Electricity Distribution Pricing 2004/05 to 2008/09: Final Report*, June 2004, pp 144 – 145.

¹⁰ Energex, *Pricing Proposal for the period 1 July 2010 – 30 June 2011*, May 2010, p 44.

These costs are recovered by Ergon Energy as part of the TUOS charges passed through to customers.”¹¹

Given the relatively wide nature of distribution services that may potentially be provided by one DNSP to another DNSP, it is considered preferable not to provide for a definition of “inter-DNSP payments”. However, if there is to be any definition for the term “inter-DNSP payments” it is suggested that a definition based on that used by IPART is adopted, for example: “a payment between distributors for use of the distribution system”.¹²

In light of the different approaches taken to payments between DNSPs for use of the distribution network in NSW and Victoria, the Victorian DNSPs consider that the proposed rule should be amended. The amendment to the proposed rule would provide that the pricing proposal should provide for tariffs designed to pass on to customers the charges to be incurred by the DNSP for distribution services provided by other DNSPs. The netting or otherwise of such charges is an administrative process that can be dealt with in the pricing proposal, which is subject to approval by the AER. An amended proposal is set out in Attachment A of this response.

2.7 Are there any other charges that should be included?

The Victorian DNSPs have identified a further sub-category of transmission-related charges that should be provided for in the proposed rule. These are charges related to network support agreements.

The term “network support agreement” is defined in the Rules as:

“An agreement between a *Network Service Provider* and a *Market Participant* or any other person providing *network support services* to improve *network capability* by providing a non-*network alternative to a network augmentation*.”

It is clear from the Rules that, at least insofar as a Network Service Provider implements a generation option as an alternative to network augmentation, the cost of the network support is to be included in distribution service prices. Clause 5.6.2(m) provides:

“Where the relevant *Transmission Network Service Provider* or *Distribution Network Service Provider* decides to implement a *generation* option as an alternative to *network augmentation*, the *Network Service Provider* must:

- (1) register the *generating unit* with AEMO and specify that the *generating unit* may be periodically used to provide a *network support function* and will not be eligible to set *spot prices* when *constrained on* in accordance with clause 3.9.7; and
- (2) include the cost of this *network support service* in the calculation of *transmission service* and *distribution service* prices determined in accordance with Chapter 6 or Chapter 6A, as the case may be.”

As charges associated with network support agreements cannot necessarily be forecast with any degree of accuracy as part of the distribution determination process (unless an agreement spanning a number of years has already been entered into), it is considered that these charges would be most appropriately represented in tariffs submitted as part of the annual pricing proposal process.

It is not common for DNSPs to enter into network support agreements although where the DNSP has the transmission connection planning role (as in Victoria) the likelihood increases. TNSPs more frequently enter into such agreements and there are very specific pass through provisions in Chapter 6A to deal with costs incurred under such agreements.¹³ In the absence of mirror provisions in

¹¹ Ergon Energy, *Pricing Proposal to the Australian Energy Regulator: Distribution Services for 1 July 2010 to 30 June 2011*, 4 June 2010, p 27.

¹² <http://www.ipart.nsw.gov.au/glossary.asp#> (accessed 1 October 2010). Note the definition used by IPART refers to the “distribution network”. As the definition of “network” under the Rules excludes connection assets it is considered preferable to use the term “distribution system”.

¹³ See in particular clause 6A.7.2.

Chapter 6, dealing with costs incurred under these agreements is most efficiently done as part of the annual pricing proposal process. Given the relative infrequency with which network support agreements are likely to be entered into by DNSPs it is not considered efficient to attempt to replicate in Chapter 6 the more detailed provisions associated with network support in Chapter 6A.

2.8 What factors should be considered in order to establish the appropriate level of prescription in defining the relevant charges?

As noted in the example provided in relation to inter-DNSP payments in section 2.6 above, regulatory practice in relation to the pass through of transmission related costs may have developed differently in the various National Electricity Market jurisdictions. As noted in section 2.4 above, it is also possible that different approaches can be taken to how services provided by the transmission system may be properly characterised. On account of these and other possible considerations, it is important that the terms adopted in any change to clause 6.18.7 should not be overly prescriptive.

2.9 What level of transparency would be appropriate for how transmission service charges, avoided TUOS payments and inter-DNSP payments are calculated?

The Victorian DNSPs consider that the current level of transparency that applies to how transmission service charges, avoided TUOS payments and inter-DNSP payments are calculated is appropriate.

Under clause 6.12.1(19) of the Rules, the AER is required to make a decision as part of a distribution determination on:

“how the Distribution Network Service Provider is to report to the AER on its recovery of Transmission Use of System charges for each regulatory year of the regulatory control period and on the adjustments to be made to subsequent pricing proposals to account for over or under recovery of those charges.”

Pursuant to clause 6.18.8, the AER must approve a pricing proposal if the AER is satisfied of various matters. These include:

- that the proposal complies with Part I of the Rules and any applicable distribution determination; and
- that all forecasts associated with the proposal are reasonable.

In recent distribution determinations, the AER has required that amounts provided by the DNSPs for the most recently completed regulatory year must be audited.¹⁴ The annual pricing proposals that are submitted to the AER for approval are very detailed. The Victorian DNSPs are not aware that the AER has determined any recent pricing proposals to be deficient.

The Victorian DNSPs submit that the manner in which the AER currently requires those DNSPs that have been the subject of distribution determinations under Chapter 6 (and the transitional Chapter 6 in Chapter 11 of the Rules) to report on the calculation of tariffs - designed to pass on to customers transmission-related charges - provides an appropriate level of transparency. The Victorian DNSPs are not aware that any concerns or issues have been raised as to the current level of transparency in the calculation of these charges in the annual pricing proposals that have been submitted by the relevant DNSPs.

¹⁴ AER, *New South Wales Distribution Determination 2009-10 to 2013-14: Final Decision*, 28 April 2009, Appendix I, p 462; AER, *Queensland Distribution Determination 2010 – 11 to 2014 – 15: Final Decision*, May 2010, Appendix E, p 395; AER, *South Australia Distribution Determination 2010 – 11 to 2014 – 15: Final Decision*, May 2010, Appendix F, p 322.

3 How should the charges be recovered?

3.1 Are charges for 'transmission services', inter-DNSP payments and avoided TUOS payments outside the control of DNSPs (or subject to other regulatory oversight)?

Please see response in section 2.3 above and 3.3 below.

3.2 If DNSPs have some control over the level of these costs, would including these costs to be passed through directly under the pricing process provide sufficient incentive to ensure that these costs are minimised?

Please see response in section 2.3 above.

3.3 Should any of these costs be included in the distribution determination process?

The Victorian DNSPs do not consider it appropriate that any of the costs - that have been identified as being appropriately dealt with in the annual pricing proposal process - should be included in the distribution determination process. Specifically, and as set out in detail below, the Victorian DNSPs would resist very strongly any suggestion that it would be more consistent with the national electricity objective and/or the revenue and pricing principles for such costs to be forecast as a part of the operating expenditure building block in the distribution determination process, as opposed to dealing with these costs through the annual pricing proposal process.

Whilst recovery of the identified cost components by DNSPs is clearly consistent with the national electricity objective and the revenue and pricing principles - the classification of the identified cost components as operating expenditure, and recovery of them as a part of forecast operating expenditure would not promote the national electricity objective and the revenue and pricing principles to the same extent as would the recovery of these costs through the DNSPs annual pricing proposal process.

The rule change proposal involves explicitly providing for the recovery of the cost components via the annual pricing proposal process. The direct pass through of the actual costs which a DNSP incurs in relation to the identified cost components via the annual pricing process ensures that a DNSP will recover only its actual charges, while simultaneously providing an assurance to end-users that they will only pay for the actual expenses incurred by a DNSP in respect of the relevant cost components. The approach set out in the rule change proposal has considerable merit over an alternative method which might result in DNSPs having to characterise the relevant cost components as forecast operating expenditure.

The Victorian DNSPs are not aware of any DNSP with a relevant distribution determination made by the AER under Chapter 6 which recovers charges associated with transmission connection costs, avoided TUOS payments and inter-DNSP payments as part of an operating expenditure forecast pursuant to clause 6.5.6 of the Rules. That is, the Victorian DNSPs understand that all DNSPs that have a relevant distribution determination made by the AER under Chapter 6 (or relevant transitional provisions) recover transmission-related costs as pass through amounts which are approved pursuant to their annual pricing proposals.

The presumption should also not be made that DNSPs are able to recover all transmission-related payments as forecast operating expenditure pursuant to clause 6.5.6. Even if it were feasible, an outcome of this nature would not necessarily be desirable from a policy perspective.

Setting to one side the issue of whether transmission service charges, inter-DNSP payments and avoided customer TUOS charges could form part of a DNSP's forecast operating expenditure, there is a real policy question as to whether a framework that provides for the recovery of these charges as a part of forecast operating expenditure is either desirable or preferable to the current counterfactual.

A DNSP would encounter obstacles when preparing forecasts of inter-DNSP payments, avoided customer TUOS charges, and costs associated with transmission services (such as transmission

connection costs). The hurdles placed in a DNSP's path are related to regulatory processes, and the involvement of third parties, and can be characterised as follows:

- The charges incurred for prescribed transmission services are essentially determined through the AER's transmission determination for the relevant TNSP, which consists, *inter alia*, of a revenue determination for the TNSP in respect of the provision of prescribed transmission services, and a determination which specifies the pricing methodology that applies to the TNSP. The relevant transmission determination in Victoria is that which applies to SP AusNet during the period 2008–09 to 2013–14. This determination expires on 31 March 2014 and there is an expectation that it will be replaced with a new determination applying from 1 April 2014. The distribution determinations to be made by the AER will apply to the Victorian DNSPs until 31 December 2015. As there are so many unknowns, the Victorian DNSPs simply do not have the capacity to anticipate, with any degree of accuracy, the outcome of a regulatory decision which is scheduled to be brought down in three and a half years from the present date.
- The charges that will be incurred for prescribed transmission services even within the SP AusNet transmission determination period, which expires on 31 March 2014, are not necessarily certain. The charges for these services may increase or decrease as a result of pass through events or contingent projects. There is also the possibility that the existing transmission determination could be reopened and adjusted if major flaws or inadequacies are uncovered.
- A complication associated with developing predictions of avoided TUOS charges is that the DNSPs do not have adequate information as to future connections of new embedded generation. The DNSPs cannot foresee the number of new generator connections (and the output associated with each connection) over the five year term of a regulatory control period.

In short, DNSPs have little or no influence over charges for transmission services, distribution services provided by other DNSPs, or avoided customer TUOS charges. The lack of influence arises partly due to the factors set out above, but also due to other considerations. Accordingly, a DNSP faces significant challenges in the preparation of forecasts of the stated cost components. In light of the AER's draft determination for the Victorian DNSPs, some of the revised proposals have sought to forecast these cost components as part of the operating expenditure building block. However, and as set out below, it is not considered desirable from a policy perspective that the relevant cost components be recovered as operating expenditure.

An example that highlights the difficulties that may be faced in forecasting transmission-related costs is when the Victorian Government introduced a land tax on transmission easements, effective from 1 July 2004. If the Victorian DNSPs had been required to include in their operating forecasts transmission-related costs, as opposed to these being recovered outside of the operating expenditure building block, the Victorian DNSPs would not have been able to recover the increased costs passed on to them that reflected the introduction of the land tax on transmission easements.¹⁵

From a policy maker's perspective, there is little merit in permitting DNSPs to retain the benefits which result from over-prediction of the relevant charges. DNSPs are unable to exert control over the level of the charges and should not be given incentives to "outperform" the forecast costs. There is no need to establish a parallel with other components of operating expenditure which are genuinely controllable, and in relation to which adequate incentives for cost minimisation are already in place.

If a DNSP incurred lower charges for these services than it had forecast, then the savings would not necessarily reflect a relevant cost efficiency on the part of the DNSP. To allow a DNSP to keep the benefit of any over-prediction of charges for transmission services, inter-DNSP payments and avoided customer TUOS charges would be inconsistent with the incentive framework in Chapter 6, which permits a DNSP to retain the benefits of cost efficiencies.

¹⁵ See background material on the Essential Service Commission of Victoria website: <http://www.esc.vic.gov.au/public/Energy/Regulation+and+Compliance/Decisions+and+Determinations/Rebalancing+control+for+transmission+tariffs/Rebalancing+control+for+transmission+tariffs.htm> (accessed 6 October 2010).

Similarly, there would be little rationale from a policy maker's perspective in having DNSPs incur losses resulting from the under-prediction of charges for transmission services, distribution services provided by other DNSPs and avoided customer TUOS charges. Since any monetary losses would not be a consequence of cost inefficiencies on the part of the DNSPs, then it would be arbitrary and inequitable to expect DNSPs to bear the burden of the under-recovery.

There is no evidence that DNSPs would face greater incentives to strive for efficiency, and thus there would be no improvement to the attributes of the regulatory framework by comparison with the current situation.

It is possible that mechanisms could be provided for in the distribution determination that would provide for a "true-up" to deal with any over or under forecasting of the relevant cost components. That is, it is possible that the relevant cost components could be included in forecast operating expenditure with a mechanism built in to ensure that actual costs only are past through. However, it would be preferable from the perspective of administrative ease and regulatory burden to simply provide explicitly for the pass through of actual costs via the existing annual pricing proposal process.

As previously mentioned, there is a high degree of error associated with forecasting charges for transmission services, distribution services provided by other DNSPs and avoided customer TUOS charges. The consequences of such errors are potentially significant. Accordingly, a framework which provides for DNSPs to forecast these charges as part of their forecast operating expenditure in the distribution determination process will not promote the national electricity objective to the same extent as would the pass through of these costs as part of the annual pricing proposal process.

Specifically, the objective of efficient investment in, and efficient use of electricity services, particularly with respect to price, will not be promoted or enhanced in circumstances in which a DNSP bears the risk that outturn costs will differ materially from projected costs for expenditure items over which the DNSP can exert little or no control.

The proposed Rule change supports the national electricity objective and would benefit both customers and DNSPs alike. If implemented, the proposed Rule would permit DNSPs to recover transmission service costs as a form of pass through within their annual tariff proposals. The transmission tariffs charged to customers would then be a direct function of the actual costs paid by DNSPs. If, in any one year, a DNSP over-recovered its pass-through costs, then prices in the following year would come down so as to offset the over-recovery. Similarly, if, in any year, a DNSP under-recovered its pass-through costs via tariffs, then prices in the following year would need to increase so as to recoup the under-recovery amounts. Hence, if the proposed Rules are implemented, then customers will gain by paying prices for transmission services which reflect the actual costs incurred by DNSPs, of which the vast majority are regulated transmission services costs. Similarly, the DNSPs will be better placed because the impact on their cash flows will be neutral in NPV terms. There will be no undesirable effects on the incentives to connect embedded generators or to make payments to these entities.

A framework which provides for DNSPs to forecast charges for transmission services, distribution services provided by other DNSPs and avoided customer TUOS charges is also unlikely to be consistent with the revenue and pricing principles. In particular, a DNSP is unlikely to be provided with a reasonable opportunity to recover at least the efficient costs incurred in providing direct control network services if it has to bear the risk of forecast error. A DNSP could alternately gain or lose significant dollar amounts if outturn costs are substantially lower or higher than forecast values.

4 How to ensure administrative efficiency?

4.1 What factors should be taken into consideration to ensure that any amendments to the revenue determination and pricing process minimises the administrative costs of the AER and DNSPs?

The Victorian DNSPs submit that the proposed rule change has no relevant impact on the administrative costs of the AER and DNSPs because the proposed rule change simply seeks to codify the existing regulatory practice of the AER.

However, to the extent that the AER maintains its position as set out in the Victorian draft distribution determination (that transmission connection charges, inter-DNSP payments and avoided TUOS charges cannot be recovered under clause 6.18.7¹⁶) and seeks to apply this position in other jurisdictions it is likely that the administrative costs of the AER and DNSPs will increase significantly. This is because recovery of these charges will then need to be attempted through either forecast operating expenditure (which for the reasons set out in section 3.3 above is undesirable) or as pass through events. In relation to recovery of these costs via a pass through event, the administrative burden would be significant as DNSPs would be continually submitting applications for pass through of these costs, as opposed to dealing with them once a year via the annual pricing proposal process.

5 What savings and transitional requirements would be required?

The AER's final distribution determination for the Victorian DNSPs is anticipated to be published in late October 2010. As noted in the AEMC's consultation paper, the rule change process will not be completed before October 2010, and so if a rule were to be made, savings and transitional arrangements would likely be required to allow any rule made to be applied at the earliest opportunity. Furthermore, any savings and transitional provisions may need to take into account distribution determinations and pricing proposals that are already in place.

In terms of transitional provisions that may apply to the Victorian DNSPs, it is proposed that there be a limited re-opening of the relevant distribution determinations only to the extent necessary to make those determinations consistent with the rule provisions that are amended as a consequence of any rule change.

In their revised proposals, the Victorian DNSPs disagreed with the AER's position in relation to clause 6.18.7 and proposed that, in the event that the AER rejected the proposed WAPC or side constraint terms regarding transmission-related costs, the AER must:

- increase forecast operating expenditure to include the estimated amounts of the transmission-related costs for 2011-15 set out in the revised proposals; and/or
- accept a 'transmission related costs event' as an additional nominated pass through event covering the difference between forecast and actual expenditure in respect of transmission-related costs, with a materiality threshold of zero.¹⁷

AER staff indicated in a recent meeting with the Victorian DNSPs (held on 1st October 2010) that the AER's position in relation to clause 6.18.7 would not change as between the draft and the final decision. Furthermore, AER staff indicated that recovery of transmission-related charges would not be dealt with through either forecast operating expenditure or as a pass-through event.

Until the AER's final distribution determination is made it is unclear what appropriate savings and transitional provisions may be required in respect of the position of the Victorian DNSPs. As the AER's position in relation to the distribution determinations it has made, and the pricing proposals that it has approved, including for NSW, Queensland and South Australia, is also not known, it is also unclear what savings and transitional provisions may be appropriate for these jurisdictions.

On an interim basis the Victorian DNSPs propose the following savings and transitional provisions in the event an amendment is made to clause 6.18.7 (and related clauses):

- for the Victorian DNSPs, following any amendment to clause 6.18.7, the AER and the relevant Victorian DNSPs will agree on any amendments to the distribution determination and any approved pricing proposals required to give effect to the amended clause 6.18.7 (and related

¹⁶ AER, *Victorian Electricity Distribution Network Service Providers Distribution Determination 2011 – 2015*, June 2010, pp 64 – 66.

¹⁷ Citipower, *Revised Regulatory Proposal 2011 to 2015*, 21 July 2010, p 37; Jemena Electricity Networks, *Revised Regulatory Proposal*, 20 July 2010, p 34; Powercor, *Revised Regulatory Proposal 2011 to 2015*, 21 July 2010, pp 65 – 68; SP AusNet, *Electricity Distribution Price Review 2011 – 2015: Revised Regulatory Proposal*, July 2010, p 373; United Energy, *Revised Regulatory Proposal for Distribution Prices and Services January 2011 – December 2015*, July 2010, pp 280 – 281.

clauses) as if that clause (and related clauses) in its amended form had applied from 30 November 2009, and the distribution determination and approved pricing proposal will be re-opened only to the extent necessary to give effect to the amendments agreed between the AER and the relevant Victorian DNSP; and

- for distribution determinations and pricing proposals made and approved under the old clause 6.18.7 (and related clauses), the validity of those determinations and proposals is not affected only as a consequence of any amendments to clause 6.18.7 (and related clauses).

Attachment A: Revised proposed rule

The proposed amendments to the clauses 6.18.2 and 6.18.7 (and consequential clauses) are set out below. Insertions are shown as blue double underlined text and deletions are shown as red strike-through text.

The revisions that have been made to the proposed rule are as follows:

- to provide for revisions to Chapter 6 and to transitional Chapter 6 in Appendix 1 of Chapter 11 of the Rules (which applies to electricity distributors in NSW and the ACT);
- to simplify the amendments, the relevant categories of charges are specified once (in clause 6.18.7(a)), with related clauses just referring to “the items specified in clause 6.18.7(a)”;
- the category of network support agreements has been added to clause 6.18.7; and
- proposed savings and transitional provisions to be inserted into Chapter 11 have been added.

Proposed revisions to Chapter 6 and NSW and ACT transitional Chapter 6 (Appendix 1 in Chapter 11)

6.18.2 Pricing proposals

...

(b) A *pricing proposal* must:

...

- (6) set out how the charges for the items specified in clause 6.18.7(a) and incurred by the *Distribution Network Service Provider* for ~~transmission use of system services~~ are to be passed on to customers and any adjustments to tariffs resulting from over or under recovery of those charges in the previous *regulatory year*, and...

6.18.7 Recovery of charges incurred by *Distribution Network Service Providers* for ~~transmission use of system services~~

(a) A *pricing proposal* must provide for tariffs designed to pass on to customers the charges to be incurred by the *Distribution Network Service Provider* for the following items ~~transmission use of system services~~ (excluding amounts subject to clause 6.18.7A):

(1) *transmission services*;

(2) *distribution services provided by other *Distribution Network Service Providers**;

(3) *avoided Customer TUOS charges*; and

(4) *network support agreements*.

(b) The amount to be passed on to customers for a particular *regulatory year* must not exceed the estimated amount of the ~~transmission use of system~~

charges [for the items listed in paragraph \(a\)](#) for the relevant *regulatory year* adjusted for over or under recovery in the previous *regulatory year*.

- (c) The extent of the over or under recovery is the difference between:
- (1) the amount actually paid by the *Distribution Network Service Provider* by way of ~~transmission-use-of-system~~ charges for [the items listed in paragraph \(a\)](#) in the previous *regulatory year*; and
 - (2) the amount passed on to customers by way of ~~transmission-use-of-system~~ charges [for the items listed in paragraph \(a\)](#) by the *Distribution Network Service Provider* in the previous *regulatory year*.

Other consequential amendments include the following:

6.12.1 Constituent decisions

A distribution determination is predicated on the following decisions by the *AER* (*constituent decisions*):

...

- (19) a decision on how the *Distribution Network Service Provider* is to report to the *AER* on its recovery of ~~transmission-use-of-system~~ charges for [the items specified in clause 6.18.7\(a\)](#) for each *regulatory year* of the *regulatory control period* and on the adjustments to be made to subsequent *pricing proposals* to account for over or under recovery of those charges; and...

6.18.6 Side constraints on tariffs for standard control services

...

- (d) In deciding whether the permissible percentage has been exceeded in a particular *regulatory year*, the following are to be disregarded:
- (1) the recovery of revenue to accommodate a variation to the distribution determination under rule 6.6 or 6.13;
 - (2) the recovery of revenue to accommodate pass through of charges for [the items specified in clause 6.18.7\(a\)](#) ~~transmission-use-of-system~~ to customers; and...

Chapter 11

11.X Rules consequential on the making of National Electricity Amendment (DNSP Recovery of Transmission-related Charges) Rule 2010

11.X.1 Definitions

For the purposes of this rule 11.X:

amending Rule means the National Electricity Amendment (DNSP Recovery of Transmission-related Charges) Rule 2010.

commencement date means the date the Amending rule commences operation.

new clause 6.12.1 means clause 6.12.1 after the commencement of the amending Rule.

new clause 6.18.7 means clause 6.18.7 after the commencement of the amending Rule.

Victorian *Distribution Network Service Provider* means any of: CitiPower Pty; Jemena Electricity Networks (Vic) Ltd; PowerCor Australia Limited; SPI Electricity Pty Ltd; United Energy Distribution.

11.X.2 Validity of distribution determinations and pricing proposals

Nothing in the amending Rule affects the validity of:

- (a) a distribution determination made prior to the commencement date; or
- (b) a *pricing proposal* approved by the *AER* prior to the commencement date.

11.X.3 Variation of distribution determinations and approved pricing proposals applying to Victorian *Distribution Network Service Providers* during the regulatory period 1 January 2011 to 31 December 2015

- (a) The *AER* and the relevant Victorian *Distribution Network Service Provider* must agree any variations required to the distribution determination made and any *pricing proposals* approved by the *AER* to apply during the period 1 January 2011 to 31 December 2015 to give effect to the new clause 6.12.1 and the new clause 6.18.7 as if the form of the new clause 6.12.1 and the new clause 6.18.7 had applied from 30 November 2009.
- (b) Following agreement between the *AER* and the relevant Victorian *Distribution Network Service Provider* pursuant to paragraph (a), the *AER* must vary the distribution determination and approved *pricing proposal* only to the extent necessary to give effect to the agreement between the *AER* and the relevant Victorian *Distribution Network Service Provider*.
- (c) The *AER* and the relevant Victorian *Distribution Network Service Provider* may consult with other persons on the variations to the relevant distribution determination and approved *pricing proposal* as considered appropriate.