



DRAFT DECISION

TasNetworks Transmission Determination 2019 to 2024

Attachment 11 Pricing methodology

September 2018

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Note

This attachment forms part of the AER's draft decision on TasNetworks' 2019–24 transmission determination. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure a

Attachment 6– Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Pricing methodology

Attachment 12 – Pass through events

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Shortened forms

Shortened form	Extended form
AARR	aggregate annual revenue requirement
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ASRR	annual service revenue requirement
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CCP13	Consumer Challenge Panel, sub panel 13
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIAM	demand management innovation allowance (mechanism)
DMIS	demand management incentive scheme
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
F&A	framework and approach
MAR	maximum allowed revenue
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
opex	operating expenditure

Shortened form	Extended form
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
TNSP	transmission network service provider
TUoS	transmission use of system
WACC	weighted average cost of capital

11 Pricing methodology

This attachment sets out our draft decision on TasNetworks' proposed pricing methodology for the 2019–24 regulatory control period.

A pricing methodology forms part of our transmission determination.¹ Its role is to answer the question 'who should pay how much'² in order for a transmission business to recover its costs. To do this, a pricing methodology must provide a 'formula, process or approach'³ that when applied:

- allocates the aggregate annual revenue requirement to the categories of prescribed transmission services that a transmission business provides and to the connection points of network users⁴
- determines the structure of prices that a transmission business may charge for each category of prescribed transmission services.⁵

An approved pricing methodology does not relate to negotiated transmission services or other transmission services not subject to economic regulation under the Rules.

11.1 Draft decision

Our draft decision is to accept TasNetworks' pricing methodology for the 2019–24 regulatory control period. This is because it gives effect to the pricing principles in the NER and complies with the information requirements set out in the pricing methodology guidelines.⁶

11.2 TasNetworks' proposal

TasNetworks' proposed pricing methodology is largely unchanged from its current, approved, form. Only minor changes have been made to update the document.

Key elements of TasNetworks' pricing methodology include:

- calculation of the locational component of prescribed TUOS services costs using the modified cost reflective network pricing methodology
- locational prescribed TUOS services price based on contract agreed maximum demand

¹ NER, clause 6A.2.2(4).

² AEMC, *Rule determination: National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No. 22*, 21 December 2006, p. 1.

³ NER, 6A.24.1(b).

⁴ NER, clause 6A.24.1(b)(1).

⁵ NER, clause 6A.24.1(b)(4).

⁶ NER, clause 6A.24.1(c).

- postage-stamp basis of pricing structures for the non-locational component of prescribed TUOS services and prescribed common transmission services based on contract agreed maximum demand or historical energy
- methodology for implementation of priority ordering
- description of how asset costs which may be attributable to both prescribed entry services and prescribed exit services will be allocated at a connection point
- description of billing arrangements
- description of prudential requirements
- description of any differences between the pricing methodology applied during the current regulatory control period and that proposed for the next regulatory control period
- description of how TasNetworks intends to monitor and develop records of its compliance with its approved pricing methodology, the Pricing Principles for Prescribed Transmission Services (clause 6A.23 of the Rules) and part J of the Rules in general.

11.3 Assessment approach

We must approve a proposed pricing methodology if satisfied it:

- gives effect to, and complies with, the pricing principles for prescribed transmission services
- complies with information requirements of the pricing methodology guidelines.

TasNetworks' proposed pricing methodology is consistent with its existing approved methodology.

11.4 Reasons for draft decision

Our draft decision is to approve TasNetworks' proposed pricing methodology.

We consider TasNetworks' proposed pricing methodology meets the requirements of the NER pricing principles. The pricing principles are intended to provide scope for transmission businesses to develop pricing arrangements that address the circumstances in which they operate their network.⁷

Calculation and allocation of the aggregate annual revenue requirement

We assessed TasNetworks' method for calculating and allocating its aggregate annual revenue requirement, and consider that it meets the NER requirements.

⁷ AEMC, *Rule Determination: National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No 22*, 21 December 2006, pp. 27–28.

The aggregate annual revenue requirement is the 'maximum allowed revenue' adjusted:

- in accordance with clause 6A.3.2 of the NER, for a number of factors such as cost pass throughs, service target performance incentive scheme outcomes and contingent projects
- by subtracting the operating and maintenance costs expected to be incurred in the provision of prescribed common transmission services.

Table 11.1 summarises our review of how TasNetworks' proposed pricing methodology calculates and allocates the business's aggregate annual revenue requirement.

Table 11.1 TasNetworks' proposed calculation and allocation of the AARR against the NER requirements

• NER requirements	• Assessment
• Requirement for the AARR to be calculated as defined in the NER—clause 6A.22.1	• Section 6.3 of TasNetworks' proposed pricing methodology satisfies this requirement.
• Requirement for the AARR to be allocated to each category of prescribed transmission services in accordance with attributable cost share for each such category of service—clause 6A.23.2(a)	• Section 6.3 and Appendix B of TasNetworks' proposed pricing methodology satisfies this requirement.
• Requirement for every portion of the AARR to be allocated and for the same portion of AARR not to be allocated more than once—clause 6A.23.2(c)	• Section 6.3 and Appendix B of TasNetworks' proposed pricing methodology satisfies this requirement.
• Subject to clause 11.6.11 of the NER, requirement for adjusting attributable cost share and priority ordering approach to asset costs that would otherwise be attributed to the provision of more than one category of prescribed transmission services— clause 6A.23.2(d)	• Section 6.3 and Appendix B of TasNetworks' proposed pricing methodology satisfies this requirement.

Allocation of the ASRR to transmission network connection points

We assessed TasNetworks' proposed pricing methodology for allocating the ASRR, and consider it meets the NER requirements. Table 11.2 summarises our assessment.

Table 11.2 TasNetworks' proposed allocation of the ASRR against the NER requirements

NER requirements	AER assessment
Requirement for whole ASRR for prescribed entry services to be allocated to transmission network connection points in accordance with the attributable connection point cost share for prescribed entry services that are provided by the TNSP at that connection point—clause 6A.23.3(a)	Section 6.9.1 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for the whole ASRR prescribed exit services to be allocated to transmission network connection points in accordance with the attributable connection point cost share for prescribed exit services that are provided by the TNSP at that connection point—clause 6A.23.3(b)	Section 6.9.2 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for the allocation of the ASRR for: <ul style="list-style-type: none"> • prescribed TUOS services • locational components • pre-adjusted non-locational components —clause 6A.23.3(c)	Section 6.9.3 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for adjusting attributable cost share and priority ordering approach to asset costs that would otherwise be attributed to the provision of more than one category of prescribed transmission services—clause 6A.23.2(d)	Appendix D of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for the recovery of the ASRR for prescribed common transmission services and the operating and maintenance costs incurred in the provision of those services to be recovered through prices charged to transmission customers and network service and network service provider transmission connection points set in accordance with price structure principles set out in clause 6A.23.4—clause 6A.23.3(f)	Section 6.11.4 of TasNetworks' proposed pricing methodology satisfies this requirement.

Development of price structure

We assessed TasNetworks' proposed pricing methodology and process for developing different prices for recovering the ASRR, and consider it meets the NER requirements. Table 11.3 sets out the assessment.

Table 11.3 TasNetworks' proposed pricing structure against the NER requirements

NER requirements	AER assessment
Requirement for separate prices for each category of prescribed transmission services—clause 6A.23.4(b)	Section 6.11 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for fixed annual amount prices for prescribed entry services and prescribed exit services—clause 6A.23.4(c)	Section 6.11.1 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for postage stamped prices for prescribed common transmission services—clause 6A.23.4(d)	Section 6.11.4 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for prices for locational component of prescribed TUOS services to be based on demand at times of greatest use of the transmission network and for which network investment is most likely to be contemplated—clause 6A.23.4(e)	Section 6.11.2 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for prices for the locational component of ASRR for prescribed TUOS services not to change by more than 2 per cent per year compared with the load weighted average prices for this component for the relevant region—clause 6A.23.4 to clause 6A.23.4(f)	Section 6.11.2 of TasNetworks' proposed pricing methodology satisfies this requirement.
Requirement for prices for the adjusted non-locational component of prescribed TUOS services to be on a postage stamp basis—clause 6A.23.4(j)	Section 6.11.3 of TasNetworks' proposed pricing methodology satisfies this requirement.

Information requirements

We are satisfied TasNetworks' proposed pricing methodology complies with the information requirements of the pricing methodology guidelines.