Draft Decision

ActewAGL distribution determination

2015–16 to 2018–19

Attachment 19: Pricing methodology

November 2014

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Note

This attachment forms part of the AER's draft decision on ActewAGL's 2015–19 distribution determination. It should be read with other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Value of imputation credits

Attachment 5 – Regulatory depreciation

Attachment 6 – Capital expenditure

Attachment 7 – Operating expenditure

Attachment 8 – Corporate income tax

Attachment 9 – Efficiency benefit sharing scheme

Attachment 10 – Capital expenditure sharing scheme

Attachment 11 – Service target performance incentive scheme

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Attachment 13 – Classification of services

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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	aggregate service revenue requirement
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
CPI-X	consumer price index minus X
DRP	debt risk premium
DMIA	demand management innovation allowance
DMIS	demand management incentive scheme
distributor	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
expenditure assessment guideline	expenditure forecast assessment guideline for electricity distribution
F&A	framework and approach
MRP	market risk premium

Shortened form	Extended form
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
PPI	partial performance indicators
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 pricing principles
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital

19 Pricing methodology

A pricing methodology forms part of our regulatory determination.[1] Its role is to answer the question 'who should pay how much'[2] in order for a network business to recover its costs relating to transmission services. 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 network business provides and to the connection points of network users[4]
- determines the structure of prices that a network business may charge for each category of prescribed transmission services.[5]

ActewAGL must submit a pricing methodology to us for approval because its network comprises of distribution and dual function assets, which are subject to the pricing arrangements for transmission standard control services.[6] Specifically, ActewAGL provides 'distribution services within the ACT and transmission services to the south eastern region of NSW'.[7]

This attachment sets out the determination on ActewAGL's proposed pricing methodology for the 2015–19 regulatory control period.

19.1 Draft decision

We do not approve ActewAGL's proposed pricing methodology for the 2015–19 regulatory control period. Some sections of ActewAGL's proposal include aspects of the pricing methodology that TransGrid proposed for its 2015–18 regulatory control period. Our draft decision for TransGrid is not to accept its pricing methodology. It follows that we do not accept ActewAGL's methodology for the same reasons. We expect that ActewAGL will engage with TransGrid about the changes both should make before submitting a revised pricing methodology.

19.2 ActewAGL's proposal

In May this year, ActewAGL submitted its proposed pricing methodology for the 2015–19 regulatory control period. It noted that certain requirements under the pricing principles in the NER and pricing methodology guidelines were picked up by TransGrid in the pricing methodology it submitted to us.

These requirements are:

- any adjustments required to be made to the locational component of the annual service revenue requirement (ASRR) as required in the NER
- any adjustments required to be made to the pre–adjusted non–locational component of the ASRR as required in the NER.

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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)(2).
6 AER, Stage 1 Framework and approach paper – ActewAGL, March 2013, p. 42.
7 ActewAGL, *Proposed transmission pricing methodology,* May 2014, p. 2.

- allocation of the locational component of prescribed TUoS services to transmission connection points
- establishing the structure and price for prescribed transmission services.[8]

19.3 AER's assessment approach

We must approve a proposed pricing methodology if satisfied that it:

- gives effect to, and complies with, the pricing principles for prescribed transmission services
- complies with the information requirements of the pricing methodology guidelines.[9]

19.4 Reasons for draft decision

Our draft decision is to not accept ActewAGL's proposed pricing methodology. We assessed that the pricing methodology is essentially though not entirely the same as the methodology we approved for ActewAGL's 2009–14 regulatory control period. However, aspects of ActewAGL's current proposal adopt the arrangements TransGrid put forward in its proposed pricing methodology for its 2015–18 period and which we did not accept. It follows we should not accept ActewAGL's proposal either.

Notwithstanding this, we agree that it is appropriate for ActewAGL to adopt aspects of TransGrid's pricing methodology. Where there are multiple transmission businesses in a region, those businesses must appoint a co-ordinating network service provider.[10] In ActewAGL's case, it has appointed TransGrid. In accordance with the NER, TransGrid is therefore responsible for allocating all relevant aggregate annual revenue requirement (AARR) in its region (NSW).[11] This includes ActewAGL's AARR. In such circumstances, ActewAGL's proposal to adopt the requirements from TransGrid's proposal set in 1.2 aboveis appropriate.

This, however, requires us to clarify how ActewAGL and TransGrid's pricing methodologies will interact. We note that the lengths of the two businesses' regulatory control periods are different. ActewAGL's is from 1 July 2015 to 30 June 2019. TransGrid's regulatory control period has the same commencement date, but ends a financial year earlier (30 June 2018).

In this context, we confirm that the aspects of TransGrid's 2015–18 pricing methodology which ActewAGL adopts will apply to ActewAGL for its entire 2015–19 regulatory control period. To avoid any doubt, if TransGrid submits a modified pricing methodology for its next regulatory control period (2018–19 and beyond), those modification will not apply to ActewAGL in 2018–19. This is consistent with the NER requirement that the same pricing methodology applies to a business for it full regulatory control period.[12]

8 ActewAGL, *Proposed transmission pricing methodology,* May 2014, p. 5.
9 NER, clause 6A.24.1(c).
10 NER, clause 6A.29.1(a).
11 NER, clause 6A.29.1(d).
12 NER, clause 6A.24.1(e) and (f).

19.4.1 Assessment against the pricing principles

We consider ActewAGL's proposed pricing methodology accords with 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.[13]

Calculation and allocation of the aggregate annual revenue requirement

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

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

Table 19.1 ActewAGL 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 3.2 of ActewAGL's proposed pricing methodology complies with 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 3.3 and Appendix 1 of ActewAGL's proposed pricing methodology complies with 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 3.3 and Appendix 1 of ActewAGL's proposed pricing methodology complies with 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)	Appendix 1 of ActewAGL's proposed pricing methodology complies with this requirement.

Source: ActewAGL, *Proposed transmission pricing methodology*, May 2014.

Allocation of the ASRR to transmission network connection points

We assessed ActewAGL's proposed pricing methodology for allocating the ASRR and consider it meets the NER requirements. The exception to this is the requirement to allocate the annual service revenue requirement (ASRR) to prescribed TUoS services. Table 19.2 summarises our assessment.

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

Table 19.2 ActewAGL' 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 3.5.1 of ActewAGL's proposed pricing methodology complies with 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 3.5.2 of ActewAGL's proposed pricing methodology complies with this requirement.
Requirement for the allocation of the ASRR for: prescribed TUOS services locational components pre-adjusted non-locational components —clause 6A.23.3(c)	The allocation of the locational component of prescribed TUoS services will be carried out by TransGrid on the behalf of ActewAGL. Our draft decision is to not approve this aspect of TransGrid's proposed pricing methodology, so it follows that we do not accept this part of ActewAGL's proposal too.
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 3.5.4 and Appendix 1 of ActewAGL's proposed pricing methodology complies with 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 3.7 of ActewAGL's proposed pricing methodology complies with this requirement.

Source: ActewAGL, *Proposed transmission pricing methodology*, May 2014.

Development of price structure

A pricing methodology must develop a price structure which complies with the NER.[14] However, ActewAGL did not set out how it will develop a price structure in its proposal. It stated that TransGrid is responsible for undertaking this for 'common, general, and locational charges at each of ActewAGL's transmission connection points'.[15]

We are satisfied that it is appropriate for TransGrid, as the co–ordinating network service provider in NSW, to develop the price structure for ActewAGL's prescribed transmission services. However, because we did not approve TransGrid's proposed pricing structure in its entirety, we cannot accept

14 NER, clause 6A.23.4.
15 ActewAGL, *Proposed transmission pricing methodology,* May 2014, p. 7.

this aspect of ActewAGL's proposal. We expect that ActewAGL will engage with TransGrid about the changes it makes before submitting a revised pricing methodology.

In particular, we did not accept TransGrid's proposed postage stamp structure for non–locational TUoS services. We considered the proposal offers potential benefits but concluded that a particular element of the pricing structure—a side constraint—did not comply with the requirement to charge non–locational TUoS services on a 'postage stamp basis'.[16] Our draft decision for TransGrid sets out our reasons in more detail.

19.4.2 Information requirements

The AER is satisfied that the proposed pricing methodology complies with the information requirements of the pricing methodology guidelines. Key features of the proposal include:

- acknowledging that ActewAGL is the only transmission business in its region (ACT)
- calculating the locational component of prescribed TUOS services costs using a cost reflective network pricing methodology
- basing the locational prescribed TUOS services price on an agreed nominated demand and the average half hourly demand
- basing the postage stamp pricing structure for the non-locational component of prescribed TUOS services and prescribed common transmission services on contract agreed maximum demand or historical energy
- using the priority ordering approach under clause 6A.23.3(d) of the NER to implement priority ordering
- describing how asset costs that may be attributable to both prescribed entry services and prescribed exit services will be allocated at a connection point
- describing billing arrangements as in clause 6A.27 of the NER
- describing prudential requirements as in clause 6A.28 of the NER
- including hypothetical examples
- describing how ActewAGL intends to monitor and develop records of its compliance with its approved pricing methodology.

[16] NER, clause 6A.23.4(j).