AUSTRALIAN ENERGY REGULATOR

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03 June 2022

Anna Collyer
Chair
Australian Energy Market Commission
GPO Box 2603
SYDNEY NSW 2001

Dear Ms Collyer

Re: Recovering the cost of AEMO's participant fees

We thank you for the opportunity to comment on Energy Networks Australia's (ENA) proposal to establish a new mechanism to allow Transmission Network Service Providers (TNSPs) to more directly pass on to their customers new participant fees that the Australian Energy Market Operator (AEMO) recently decided to allocate to TNSPs.

The Australian Energy Regulator (AER) has considered the ENA's rule change proposal and on balance, does not support the proposed change. The AER considers the NEO would be better achieved by TNSPs recovering participant fees, which constitutes operating expenditure, through the existing mechanisms (i.e. revenue determination and cost pass through applications).

We understand that the proposed rule change would shift recovery of AEMO participant fees from revenue determinations and cost pass through decisions to being recovered directly from transmission customers through an adjustment to their annual revenue requirements. This allows TNSPs to factor in the cost of AEMO participant fees in their transmission prices each year (annual pricing adjustment).

Under the current regulatory framework, network businesses are subject to incentive based regulation. As part of incentive regulation, we set an operating expenditure forecast at the start of a regulatory control period. Once forecasts are set at the start of the regulatory period, the network business has the opportunity to try to provide the required services for less than the forecast and retain the difference. If its spending exceeds the forecast, it must fund the difference itself. At the end of the period the benefits of an underspend (or costs of an overspend) are shared with consumers. Importantly, our approach is to assess the business' forecast operating expenditure over the regulatory control period at the total level, rather than to assess individual operating expenditure cost categories.

One of the main drivers for seeking to allow direct recovery of AEMO participant fees through an annual pricing adjustment appears to be that these costs are largely outside the control of the TNSP. We acknowledge that while TNSPs do not have direct control over the participant fees levied by AEMO, they can influence the structure and magnitude of participant fees through engagement with AEMO. Network businesses incur a number of costs which have similar characteristics to AEMO participant fees, such as government levies and taxes, and these are all classified as operating expenditure. For example, Powerlink is required under Queensland government legislation to pay an annual fee that is a portion of the Queensland Government's funding commitments to the AEMC.[1] Allowing these types of costs to be recovered directly through an annual pricing adjustment on the basis that they are largely uncontrollable erodes incentive based-regulation, reducing the incentives for network business to manage their total operating costs and does not best promote the achievement of the NEO. If AEMO participant fees are not included in operating expenditure then this reduces the incentive for TNSPs to engage with AEMO on participant fees to ensure they are set appropriately.

We note that the question of whether uncontrollable operating expenditure costs should be subject to the same incentives as controllable costs was considered during the development of the Efficiency Benefit Sharing Scheme (EBSS). We concluded that the risks of uncontrollable events present both upside and downside risk, and that there is no reason why uncontrollable cost increases should be considered differently under the regulatory framework. Relevantly, any material risks can be managed through pass-throughs and contingent projects.[2]

We consider that revenue determination arrangements and the cost pass through mechanism provide appropriate avenues for TNSPs to recover AEMO participant fees, providing TNSPs with a reasonable opportunity to recover efficient costs in accordance with the revenue and pricing principles. Further, this approach better promotes the NEO by better incentivising TNSPs to pursue efficient operating expenditure. We do not consider there is a substantive issue with these current arrangements and consider it an undesirable precedent to move toward the recovery of opex based on actual cost of service through annual adjustments in pricing, rather than the incentive based and transparent revenue determination process.

As part of the revenue determination process, network businesses often propose step changes to account for the cost of new regulatory obligations, like the AEMO participant fees. The AER will assess whether to include those step changes in developing our alternative estimate of total operating expenditure on a case by case basis, taking into account other components of the operating expenditure forecast to avoid double counting. In subsequent revenue determinations, it is unlikely we would assess the costs of the specific regulatory obligation again as the cost would form part of the base operating expenditure, which we assess from a top-down approach using a number of tools such as revealed cost and benchmarking.

If you have any questions or wish to discuss any further aspect further, please contact [redacted], Director, Policy Development Team at [redacted] or on [redacted].

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[1] Electricity and Other Legislation Amendment Bill 2014, Queensland Government, Part 2, Amendment of Electricity Act 1994

[2] AER, Efficiency Benefit Sharing Scheme – explanatory statement, November 2013, p.21-22.

Yours sincerely

[redacted]

Jim Cox
Deputy Chair
Australian Energy Regulator

Sent by email on: 03.06.2022