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Dear Mike

AER's Issues Paper on the Pricing Methodology Guidelines

Thank you for the opportunity to make submissions to the Australian Energy Regulator (AER) on its *Pricing Methodology Guidelines Issues Paper* of April 2007 (Issues Paper).

VENCorp's detailed submission in response to the Issues Paper is set out in the Attachment to this letter. In summary, VENCorp submits that:

- The information described in section 6.1 of the Issues Paper does not reflect any modifications to the operation of Part J of Chapter 6A of the NER. VENCorp observes that, in making the Guidelines, the AER must be cognisant of the limits of the power conferred on it by rule 6A.25 which makes plain that the Guidelines are not intended to be used by the AER to augment its monitoring and enforcement powers in relation to approved Pricing Methodologies;

- Permitted pricing structures have no ability to signal efficient network investment decisions as these are determined separately via regulatory test assessments, which are not driven by transmission prices. VENCorp also considers there is limited scope for locational pricing to signal efficient utilisation decisions as transmission charges represent a small component of the overall costs for new loads connecting to the network and no effect on generation location decisions;

- Locational pricing structures should be made by reference to maximum demand in a region's peak period. VENCorp submits that demand based option 4 (Option 4) best utilises actual maximum demand figures occurring at those peak times; and

- Postage stamp pricing structures should minimise distortions to users' short and long term decision-making regarding investment and consumption, so preserving signals from the location component of transmission services. VENCorp submits Postage stamp option 1 is the preferred pricing structure for the recovery of prescribed and common transmission services.

Should you have any questions in relation to the attached submission, please contact Louis Tirpcou, ☎(03) 8664 6615.

Yours sincerely

M. Zema

Matt Zema
Chief Executive Officer

att.

1. Information Requirements

In the Issues Paper, the AER queries whether there is any information, additional to that described in section 6.1 of that Paper, that would assist the AER to determine whether a TNSP's proposed Pricing Methodology is consistent with the *Pricing Principles for Prescribed Transmission Services* (Pricing Principles) and Part J of Chapter 6A of the NER (see Q1).

VENCorp observes that the information described in section 6.1 of that Paper does not reflect any modifications to the operation of Part J of Chapter 6A of the NER. Yet, information relating to the compliance of a TNSP's proposed Pricing Methodology with Part J, as modified by any Chapter 9 jurisdictional derogation, is presumably necessary to determine whether that proposed Methodology is consistent with Part J of Chapter 6A as so modified.

For example, rule 9.8.4 requires that each distributor has the benefit or burden of an equalisation adjustment calculated in accordance with that rule. It may be desirable for the Guidelines to recognise that VENCorp's proposed Pricing Methodology include information on VENCorp's proposed method for implementation of the equalisation adjustment.

In the Issues Paper, the AER also asks whether any of the information described in section 6.1 of that Paper is:

> 'unnecessary to determine whether a TNSP's proposed pricing methodology is consistent with the Pricing Principles for Prescribed Transmission Services and Part J of Chapter 6A of the NER' (see Q2).

In section 6.1, the AER would appear to contemplate that the information to be prescribed by the Guidelines for inclusion in a TNSP's proposed Pricing Methodology would include information necessary to enable the AER to:

> 'monitor, report on and enforce compliance with a TNSP's approved pricing methodology in accordance with the NER' (p.9).

VENCorp observes that, in making the Guidelines, the AER must be cognisant of the limits of the power conferred on it by rule 6A.25. The matters that may be prescribed by the AER in the Guidelines are governed by rule 6A.25.2. Relevantly, rule 6A.25.2(a) provides that the information to accompany a proposed Pricing Methodology that may be prescribed by the Guidelines is limited to:

> 'information that is necessary to allow the AER to form a view as to whether the proposed methodology is consistent with and gives effect to, the Pricing Principles for Prescribed Transmission Services and the requirements of this Part J'.

Accordingly, as reflected by the AER's question, in making the Guidelines, the AER does not have a power to require TNSPs to provide to it information for the purpose of facilitating the AER's monitoring and enforcement of the proposed Pricing Methodology, if approved.

VENCorp recognises that TNSPs have an obligation to comply with their approved Pricing Methodologies (rule 6A.24.1(d)). However, rule 6A.25.2 makes plain that the Guidelines are not intended to be used by the AER to augment its monitoring and enforcement powers in relation to approved Pricing Methodologies.

2. Permitted pricing structures (locational)

General considerations regarding locational pricing

Rule 6A.23.4(e) establishes the following Pricing Principle with which the permitted pricing structures for the locational component of prescribed TUOS services (Permitted Locational Pricing) specified by the Guidelines must comply:

> 'Prices for recovering the locational component of providing prescribed TUOS services must be based on demand at times of greatest utilisation of the transmission network and for which network investment is most likely to be contemplated'.

In addition, in specifying Permitted Locational Pricing, the AER must have regard to:

- the desirability of consistent pricing structures across the NEM; and
- the role of pricing structures in signalling efficient investment decisions and network utilisation decisions (see rule 6A.25.2(b)).

In the Issues Paper, the AER raises two general considerations regarding Permitted Locational Pricing, namely:

- the demand measure to be utilised by Permitted Locational Pricing, e.g. maximum demand or average peak demand, and demand for the NEM as a whole, or for individual regions or jurisdictions, or demand at a connection point, or alternatively contract demand, which can apply at connection points; and
- the timeframe for measuring demand, e.g. one half hour period, a day, a month or a longer period.

Possible pricing structures for the TUOS locational component

Of the demand based options proposed by the AER in its Issues Paper, VENCorp supports *demand based option 4* (Option 4). VENCorp submits that Option 4:

- is similar to VENCorp's current approach, which utilises actual maximum demand figures occurring at peak system times, as the driver of network investment;
- would be consistent with the Pricing Principle established by 6A.23.4)(e);
- would serve the relevant consideration set out in rule 6A.25.2(b)(2) - that is, the signalling of efficient investment and network utilisation decisions - to which the AER is required to have regard;
- would, relative to available alternatives, create the strongest signals for efficient network utilisation at times which drive decisions regarding network investments; and
- it could be formulated so that the 'specified period' during which maximum demand is sampled would be either a summer or winter peak.

As identified by the AER (at p.14), one issue with Option 4 is that, as it is based on historical demands, it does not cater for new loads, or loads that significantly alter their demand patterns. In this regard, VENCorp observes that:

- rather than using historical demands, VENCorp submits that Option 4 should use forecast maximum demand based on peak system times. This approach reflects VENCorp's current approach and differs from the TUOS billing process which uses forecast maximum demand values based on each user's relative demand at each connection point, together with an adjustment mechanism, under which a user receives a later payment referable to the difference between forecast and actual demands in the relevant financial year.

- for new loads, a maximum demand at the relevant connection point could be agreed for the financial year for which locational pricing is to be calculated (as contemplated by the AER's Demand based option 5 (Option 5). (This approach reflects VENCorp's current practice.)

VENCorp does not support:

- Demand based option 1 (Option 1) because it does not utilise only those maximum demand figures that occur at those times that necessitate network investment and, as acknowledged by the AER, Option 1 'would capture demand at times when the network is not fully utilised both within the billing period, and across billing periods throughout the year' (p.13). As a result, Option 1:

    - would not be consistent with the Pricing Principle established by 6A.23.4)(e);

    - would not serve the relevant consideration set out in rule 6A.25.2(b)(2) - that is, the signalling of efficient investment and network utilisation decisions - to which the AER is required to have regard; and

    - as a result, may lessen signals for efficient network utilisation at times which drive decisions regarding network investments.

- Demand based option 2 for the same reason that VENCorp does not support Option 1.

- Demand based option 3 (Option 3) because, as recognised by the AER, it does not utilise only those maximum demand figures that occur at those times that necessitate network investment and, accordingly, Option 3:

    - would not serve the relevant consideration set out in rule 6A.25.2(b)(2) - that is, the signalling of efficient investment and network utilisation decisions - to which the AER is required to have regard; and

    - as a result, may lessen signals for efficient network utilisation at times which drive decisions regarding network investments.

- Demand based option 5 because, under this Option 5, the locational charges faced by a network user would not vary in response to actual network utilisation decisions - rather, locational charges would depend on a fixed and pre-agreed maximum demand. Once the maximum demand under Option 5 has been agreed by a TNSP and the relevant network user, the user would have little incentive to modify its utilisation decisions. In addition, as recognised by the AER (at p.14), network users would have an incentive to seek to negotiate an agreed maximum demand that understates their actual or forecast maximum demand. To counter this behaviour by customer,

VENCorp currently applies a penalty charge if customers exceed their fixed maximum demand. Accordingly, while Option 5 may be structured so as to satisfy the Pricing Principle set out in rule 6A.23.4)(e), it:

- would not serve the relevant consideration set out in rule 6A.25.2(b)(2) - that is, the signalling of efficient investment and network utilisation decisions - to which the AER is required to have regard for the same reason; and

- as it lessens the degree of relationship between actual maximum demand at those times which necessitate network investment and the locational charges faced by a network user, it may lessen signals for efficient network utilisation at those times.

- Demand based option 6 (Option 6) for the reason that it would be consistent with VENCorp's current TUOS pricing arrangements, which utilise real power (kW), and there may be uncertainty as to how this approach would be used, how actual carrying capacities will be measured and what additional metering services will be required.

  VENCorp submits that it has used apparent power (kVA) as a pricing measure for other services in the past, however it does not support its use for Permitted Locational Pricing as its consistent with current TUOS pricing arrangements.

Desirability of a consistent approach to the pricing structure of prescribed TUOS services

VENCorp considers that a consistent approach across the NEM to the pricing structure of prescribed TUOS services is desirable because it will enable a network user to make 'like for like' comparisons of the costs of transmission across the various networks comprising the NEM. This, in turn, will signal efficient decisions regarding the location of new loads in the NEM.

VENCorp does not anticipate significant transitional issues as a result of moving to a NEM-wide approach to Permitted Locational Pricing. In particular, while a move to a NEM-wide approach to Permitted Locational Pricing will result in 'winners and losers amongst network customers', VENCorp observes that the 2% cap on the annual change in locational prices applies to

> 'the load weighted average price for this [locational] component for the relevant region' (rule 6A.23.4(f)).

Accordingly, VENCorp does not anticipate complex and widespread step changes for the locational component of prescribed TUOS services. Furthermore, VENCorp believes that the 2% cap on the annual change in location prices is beneficial as it minimises the effect of price shocks and provides a degree of certainty for customers.

Role of pricing structures in signalling efficient investment and utilisation decisions

VENCorp considers that the current locational pricing and proposed Permitted Locational Pricing has no ability to signal efficient network investment decisions. Augmentations to the transmission network are determined separately via regulatory test assessment and are not influenced by transmission pricing.

There is also limited scope for transmission pricing to signal investment decisions regarding the location of new loads. However, as transmission charges represent only a small proportion of the

overall costs for new entrants connecting to the network, the influence of transmission pricing to signal efficient investment decisions is deemed minor.

The extent to which locational pricing signals efficient decisions of this kind is dependent on the method employed for the allocation of the locational component of the ASRR for prescribed TUOS services to connection points, under rule 6A.23.3(c)(1). This is not a matter properly within the scope of the Guidelines (see rule 6A.25.2).

3. Permitted pricing structures (postage stamp)

Possible future postage stamping price structures

While the AER is required to have regard to 'the desirability of signaling to actual and potential Transmission Network Users efficient investment decisions and network utilisation decisions' (see rule 6A.25.2(c)), VENCorp agrees with the AER's observation of:

> '...the need to ensure that the postage stamp structures specified in the Pricing Methodology Guidelines do not cause participants to adjust their consumption of energy in order to avoid or minimise charges'.

Economic consultants advising NECA and industry in respect of the Network pricing and market network service providers Code changes (T&D Code Changes) (which resulted in the pricing structure arrangements for general and common service charges established by Part C of Chapter 6 (version 9) of the NER) were of the view that:

> 'transmission charges for residual network costs should be structured so as to minimise the effect on network users' decisions both in the short and long runs' (see p.38 and surrounding pages of the ACCC's Determination on the application for authorisation of the T&D Code Changes dated 21 September 2001).

VENCorp prefers Postage Stamp Option 1 as the pricing structure for the non-locational component of prescribed TUOS services and prescribed common services. It is of the view that Postage Stamp Option 1 recovers the costs of the non-locational component of prescribed TUOS services and common services either without distorting, or minimising the distortion to:

- decisions regarding energy consumption in order to avoid or minimise charges; and
- thus, the price signals provided by Permitted Locational Pricing and the spot price for energy.

VENCorp is only party to a small number of use of system agreements with network users that establish a contract demand. These users have the choice of either capacity or energy based prices and are billed on the lowest cost scenario. However, those users with a contract demand generally have reasonably constant usage. Given the objective of Permitted Postage Stamp Pricing to not distort consumption decisions, it is desirable for this Pricing to be capacity based for users with an agreed contract demand specified in their connection, or use of system, agreements. For those network users whose connection, or use of system, agreement does not specify a contract demand, an energy based price applicable to historical energy consumption data would best serve the object of non-distortionary cost recovery.

As Postage Stamp Option 1 is similar to the pricing structure for general and common service charges established by Part C of Chapter 6 (version 9) of the NER, the AER asks:

'...whether the arrangement under Part C of Chapter 6 (version 9) disadvantages users without an agreement which caps maximum demand. Those users are charged an energy based charge and do not have the benefit of being charged either a capacity or an energy based charge' (p.20).

VENCorp believes that this arrangement does not disadvantage users without an agreement which caps maximum demand. This is because those users that do not have a contracted maximum demand specified in their connection, or use of system, agreement, generally do not have such a contract demand because they experience marked fluctuations in their usage. As a result, the application of a capacity based charge to their (contracted) maximum demand to determine their general and common service charges would be financially disadvantageous to these users. Put another way, if VENCorp were to agree a contract demand, based on their actual maximum demand, for those users that do not presently have one, VENCorp would nonetheless expect the general and common service charges for these users to continue to be calculated using the energy based charge (because the provisions of Part C of Chapter 6 (version 9) required the one most favourable to the user to be applied).

VENCorp does not support:

- Postage stamp option 2 because a pricing structure comprised of energy based and capacity based prices is to be preferred for the reasons discussed above. If an energy based only pricing structure was to be employed, however, VENCorp observes that it should be based on historical, and not current, energy consumption. This is because:

    - it is the use of historical, and not current, energy consumption that will serve the objective of recovering the ASRR for the non-locational component of prescribed TUOS services and prescribed common transmission services in a non-distortionary manner. If charges for these services were based on current energy consumption, it may create an incentive for network users to alter their energy consumption to avoid or minimise these charges; and

    - the use of historical energy consumption is to be preferred for practical reasons. Metered data on historical energy consumption is more readily available, and will already have been settled (i.e. any corrections or adjustments will have been made) for spot market settlement purposes (provided the historical data used is that for the financial year 2 years prior to the financial year in which the relevant prices are to apply - this will be 'the most recent full financial year' at the time pricing is determined by a TNSP).

- Postage stamp option 3 because:

    - a pricing structure comprised of energy based and capacity based prices is to be preferred for the reasons discussed above; and

    - if the capacity based only pricing structure was to employ contract demand, implementation by TNSPs would be costly and time-consuming. For example, as noted above, VENCorp is only party to a very small number use of system agreements with network users that establish a contract demand. In VENCorp's opinion, there are no benefits from a capacity based only pricing structure such as would justify the incurrence of these costs.

- Postage stamp option 4 because, in the main, the demand based options proposed by the AER has as their objective signalling for efficient network utilisation decisions by network users. By

contrast, the objective of postage stamp pricing for the non-locational component of prescribed TUOS services and prescribed common services is to recover the costs of service in a non-distortionary manner. While historic demand data could be employed in a similar manner to the way in which historic energy consumption data is currently used for customer TUOS general charges in a pricing structure comprised of energy based and demand based prices, VENCorp considers that this would add little benefit relative to the use of a capacity based price in such a pricing structure.

Practical considerations

In its Issues Paper (at p.21), the AER sought submissions on alternatives to the use of current metering data for calculation of charges for new loads for prescribed common transmission services and the non-locational component of prescribed TUOS services.

VENCorp observes that, at the time of determining transmission prices for new loads, current metering data will not be available for those new loads.

At present, where new loads connect to the Victorian network, and until VENCorp has metered data for that load for a full financial year available at the time of determining transmission prices, VENCorp forecasts the user's maximum demand by modelling the likely usage in consultation with the relevant network user. The user is then billed based on the lowest cost option for prescribed common services and the non-locational component of prescribed TUOS services.

VENCorp suggests that, if Postage Stamp Option 1 is adopted, this would be a suitable methodology for determining charges for prescribed common services and the non-locational component of prescribed TUOS services for new loads.

The desirability of consistency across the NEM, particularly for customers operating across multiple jurisdictions

Provided the Permitted Postage Stamp Pricing is non-distortionary (i.e. does not cause network users to alter their consumption and network utilisation decisions so as to avoid or minimise charges), VENCorp considers there is little benefit from consistency across the NEM.

VENCorp does not consider the difference in pricing units utilised by TNSPs' current customer TUOS general charges and transmission customer common service charges to be material.

The desirability of signalling network investment and network utilisation decisions

VENCorp recognises that the AER must discharge its obligation, under the NER, to have regard to the desirability of signalling efficient investment and network utilisation decisions in specifying Permitted Postage Stamp Pricing in the Guidelines. However, this obligation does not require the AER to specify Permitted Postage Stamp Pricing that will influence users' consumption and investment behaviour.

The AEMC's intention in requiring the AER to have regard to the desirability of signalling efficient investment and network utilisation decisions was described by the AEMC as follows:

> 'In the Commission's view, the appropriate type of postage-stamping needs to reflect a balance of both:

- the importance of minimising the disincentive on Transmission Network Users to utilise the (existing sunk) network; and

- the importance of signalling the potential future impact of load growth on the need to invest in transmission or transmission alternatives'

In other words, the pricing structure needs to balance the demands of static efficiency and dynamic efficiency.' (See p.45 of the AEMC's Rule Determination: National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No 22 dated 21 December 2006.)

While the AEMC contemplated that the Permitted Postage Stamp Pricing should, at least in part, signal 'the potential future impact of load growth on the need to investment in transmission or transmission alternatives', VENCorp shares the view generally accepted by the ACCC and industry at the time of the ACCC's authorisation of the T&D Code Changes. Permitted Postage Stamp Pricing should be structured, so far as possible, to minimise distortions to users' short and long-term decision-making regarding investment and consumption, so preserving signals from spot market pricing and prices for the locational component of prescribed TUOS services.

4. Attribution of transmission system assets to categories of prescribed transmission services

VENCorp does not recover costs from prescribed entry or exit services, however, VENCorp does consult with SP AusNet to determine the correct cost allocation between shared and common service connection assets. Therefore questions regarding these categories of prescribed transmission services in the Issues Paper (p.23 and p.24) have not been addressed.

In the Issues Paper (p.25), VENCorp agrees the AER's list of transmission asset types directly attributable to prescribed common transmission services.

5. Disclosure of information

Rule 6A.25.2(e) provides that the Guidelines must prescribe:

> 'those parts (if any) of a proposed pricing methodology or the information accompanying it, that will not be publicly disclosed without the consent of the Transmission Network Service Provider'.

Consistent with this, the Issues Paper seeks guidance from interested parties on the information, associated with a Pricing Methodology, that is likely to raise confidentiality issues (see Q26).

VENCorp considers that proposed Pricing Methodologies should be capable of preparation by TNSPs in a manner that does not raise any confidentiality issues, provided the AER in prescribing information requirements in the Guidelines does not prescribe information of a kind that is likely to be confidential.

For example, the AER's list of likely required information (in section 6.1 on p.8) includes:

> 'A detailed explanation of the proposed pricing methodology, including worked examples'.

If confidentiality issues are to be avoided in the preparation of proposed Pricing Methodologies, the 'worked examples' to be included should be:

- in the nature of 'hypothetical' examples, i.e. use hypothetical data; and
- not 'real world' examples, i.e. using an actual network user and that user's load / meter data.

Provided the AER is cognisant of the implications for confidential information in prescribing information to accompany proposed Pricing Methodologies, VENCorp would endorse the AER's suggested course, namely that:

> 'it may encourage TNSPs to develop proposed pricing methodologies in a manner that avoids confidentiality issues' (p.27).