AUSTRALIAN ENERGY REGULATOR

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22 August 2022

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

Dear Ms Collyer

Re: Directions paper - recovering the cost of AEMO's participant fees

We thank you for the opportunity to respond to the Australian Energy Market Commission's (AEMC) directions paper on recovering the cost of the Australian Energy Market Operator's (AEMO's) participant fees, and the opportunity as well for the AER to participate in the discussion panel at the AEMC's workshop on the rule change proposal on 4 August 2022.

We have given further consideration to the rule change proposal, and we remain of the view that the NEO would be better achieved by TNSPs recovering participant fees through existing regulatory mechanisms (such as revenue determinations). Our reasons have largely been set out in the AER's submission to the AEMC's consultation paper on this rule change proposal. In addition, we would like to provide the following additional comments in response to the following questions raised in the directions paper.

1. *To what extent can TNSPs influence AEMO's costs, and the overall efficiency, of delivering functions for which AEMO charges them participant fees?*
2. *Reflecting on submissions and the analysis above, do you think that there is a substantial issue with the current arrangements that warrants making ENA's proposed rule?*

We note the divergence amongst stakeholder views about the degree of control or influence which TNSPs have on AEMO's costs. We consider the key question is not the degree of influence or control which a TNSP has, but rather whether this new cost can be incorporated into the existing regulatory framework and should be preferred over approaches, taking into account the National Electricity Objective and the National Electricity Law revenue and pricing principles.

While the ability of TNSPs to influence or control AEMO participant fees arguably is limited, this is no different to many other categories of operating expenditure which form part of total operating expenditure. Under the AER's incentive-based, revealed cost framework, regulated businesses are incentivised to manage the inevitable 'ups and downs' in the components of operating expenditure from year to year – to the extent they do not offset each other – by continually re-prioritising its work program, as would be expected in a workably competitive market. As noted in our initial submission, operating expenditure consists of both controllable and uncontrollable costs.

Considering the likely magnitude of AEMO participant fees and the characteristics of this cost, we consider the current arrangements are appropriate. These costs should be subject to incentive regulation and recovered as part of total operating expenditure. When first incurred, AEMO participant fees can be incorporated into the total opex forecast as a step change as part of a revenue determination. If the costs are incurred within a regulatory period, their impact on total operating expenditure will be captured by the Efficiency Benefits Sharing Scheme, and incorporated into base operating expenditure in the next revenue determination. This approach supports the NEO and also provides TNSPs a reasonable opportunity to recover their efficient costs.

One additional avenue to manage the volatility of AEMO participant fee costs, where they exceed the cost pass through materiality threshold, could be for TNSPs to propose a nominated cost pass through event as part of their revenue proposal. The AER would need to assess the nominated event definition taking into account the nominated pass through event considerations set out in the NER.[1] If the nominated pass through event is included in its revenue determination, a TNSP could then seek a cost pass through during the regulatory control period where the event definition is satisfied and costs exceed the materiality threshold.

Compared to recovery as part of total operating expenditure, we consider a direct pass through of AEMO participant fee costs would promote the NEO to a lesser extent. A direct pass through would reduce the incentive on TNSPs to pursue efficiency in total operating expenditure, and take away the incentive for TNSPs to engage with AEMO on participant fees. Increasing the portion of total operating costs being determined based on the direct cost of service serves to erode the existing incentive based regulatory approach.

Do you think it would be useful to amend the definitions of over-recovery amount and under-recovery amount, and clarify transfer payment arrangements between CNSPs and TNSPs, as proposed by ENA, even if the core element of ENA's proposed rule is not made?

We understand the revenue cap form of control set out in chapter 6A of the NER is intended to enable TNSPs to recover the revenues they are entitled[2] to for providing prescribed transmission services—no more, no less.

We also understand that differences between this revenue entitlement and the actual revenues a TNSP earns in a given year are intended to be trued up in future years via the over-recovery amount and under-recovery amount.

We therefore consider the definitions of over-recovery amount and under-recovery amount should be consistent with this intention. The AEMC noted the example of national transmission planner (NTP) fees as forming part of a TNSP's revenue entitlement, even

1 National Electricity Rules, cl. 6A.6.9(b). The nominated cost pass through event considerations are set out in chapter 10 of the National Electricity Rules.

2 This "revenue entitlement" refers to a TNSP's revenue allowance as determined by the AER, plus the adjustments required under part J of chapter 6A of the NER. This adjusted revenue allowance is what TNSPs use to set prices for prescribed transmission services.

though it is not part its revenue allowance.[3] Under current definitions in chapter 10 of the NER, NTP fees may be calculated as part of an over-recovery amount which the TNSP must then return to customers in a future year through reduced prices for prescribed transmission services.

We do not consider this is consistent with the intention under the revenue cap form of control. The AEMC is exploring whether it should exclude NTP fees from the definitions of over-recovery amount and under-recovery amount in chapter 10 of the NER to be consistent with this intention.

We support the AEMC making the necessary changes in the NER that would support and clarify the application of this intention. We consider excluding NTP fees from the definitions of over-recovery amount and under-recovery amount is one option to achieve this. Alternatively, the AEMC may amend the definitions of over-recovery amount and under-recovery amount more generally such that TNSPs would recover only their revenue entitlement even with future rule changes.

If you have any questions or wish to discuss any aspect further, please contact George Huang, Director, Policy Development Team at George.Huang@aer.gov.au or on 02 9230 3856.

Yours sincerely

James Cox

Jim Cox
Deputy Chair
Australian Energy Regulator

Sent by email on: 22.08.2022

3 AEMC, *Directions paper: Recovering the cost of AEMO's participant fees*, 21 July 2022, p. 10.