

14 March 2013

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Via website: www.aemc.gov.au

Dear John

Submission on Consultation Paper – ‘Changes to Cost Allocation Method Rules Change Request (ERC0150)’

SP AusNet welcomes the opportunity to contribute to the Australian Energy Market Commission’s (AEMC’s) deliberations on the rule change request submitted by Trans Tasman Energy Group (TTEG). The AEMC’s Consultation Paper has been helpful in understanding the issues relevant to the Commission and in assessing the merits of the proposal.

In its Victorian electricity distribution network service providers distribution determination 2011–2015 the Australian Energy Regulator (AER) has assigned the following services to be negotiated services:

- Alteration and relocation of DNSP public lighting assets;
- New public lighting assets (that is, new lighting types not subject to a regulated charge and new public lighting at greenfield sites).

SP AusNet’s experience is that there has been no material service provision under the negotiated service category within the current regulatory period commencing January 2011. The most significant alterations to public lighting have been for changeover to energy efficient lighting, and this work has been conducted through proponent councils contracting directly with an installer, and then handing the new asset to the distributor at zero value for operation and maintenance. New public lighting is largely contained to new estates, where the developer establishes the public lighting along with other estate infrastructure. Once again, on completion the assets are handed to the distributor at zero value for operation and maintenance.

With this experience, SP AusNet is not able to comment on the materiality of any difficulties that parties subject to ‘negotiated services’ may be facing. However, TTEG

raises several concerns regarding the negotiated service pricing process as justifying the proposed rule change, and in the remainder of this submission we provide our views on these issues.

1. Issues presented by the proponent

(1) Absence of consultation on cost allocation method

The Cost Allocation Method (CAM) is prepared by the DNSP and submitted to the AER for approval in accordance with the National Electricity Rules (the Rules).

TTEG proposes that the AER should consult on the DNSPs CAM in assessing it for approval. They note that the Rules require the AER to consult where it is developing or amending any guidelines, models or schemes, or in evaluating any values or methods.

There are a number of reasons why consultation on the CAM is not required by the Rules. These are:

- The consultation required by the Rules in this instance is for instruments that are owned by the AER. The 'method' of an NSP is not such an instrument;
- The CAM is developed in accordance with guidelines and must be compliant with the guidelines. The guidelines themselves are to comply with principles set out in the Rules. The guidelines are an instrument that is, appropriately, subject to consultation;
- Since the CAM is a principles based 'method', and the same principles are to be applied to all NSPs (in accordance with the guidelines) the main objective of approval is compliance. The AER has engaged independent expert consultancy to provide assurance to it in making its decisions with respect to the CAMs and their compliance;
- Annual consultation on the CAM (assuming allocators are revised annually) would not be productive, and would risk re-visiting issues debated in prior consultation on the guidelines; and
- The AER approach to determining cost allocation specific to a price / revenue determination is discussed in its Framework and Approach process, and this is the appropriate point for further consultation and opportunity for stakeholder input.

(2) Lack of transparency of the cost allocation method

TTEG is concerned that the current requirements for the CAM are not sufficiently transparent to enable effective negotiation of prices. The rule change observes that

“...customers are not able to effectively determine if the Distribution Network Service Provider’s negotiated distribution service price offer is NER compliant, including whether the same cost was allocated more than once (NER 6.15.2(5)).

However, SP AusNet does not think this concern is well-founded. The cost allocation process is designed to provide the assurance that is required by the AER and customers. The AER's approval of the CAM is the mechanism whereby the AER promulgates its confirmation that the NSP's method for allocating costs complies with all obligations. NSPs are required by the Rules to comply with their CAM, a regulatory compliance obligation, and the application of the CAM is accordingly subject to rigorous governance oversight. SP AusNet's approved CAM states that

“Associated with the preparation of annual regulatory financial information, SP AusNet engages independent auditors to audit the statutory financial statements (base accounts), internal controls and the regulatory accounts, derived from the application of the CAM”.

Further, under the clause 3.1(b)(iii) of Appendix E of the Regulatory Information Notice issued by the AER to SP AusNet on 4 June 2012, the independent auditor is specifically required to

“...assess whether the information has been prepared in accordance with the Cost Allocation Method.”

The independent audit opinion relied upon by the AER for compliance purposes with respect to the regulatory accounts should be sufficient for negotiated services customers to have confidence that the Cost Allocation Method is being followed by an NSP.

Finally, it is unclear how the quantification of allocated values would allow a negotiated services customer to establish whether an offer was NER compliant. That is, even if a CAM included a dollar value for, say, a Corporate Finance function that was allocated to Negotiated Services, TTEG is silent on how an individual negotiated services customer would use this information to meaningfully assess the price offered by an NSP.

(3) The binding nature of the principles to establish negotiated prices

TTEG proposes that the principle that prices should be based on the costs incurred in providing the service (NER clause 6.7.1(1)) should be binding, i.e. use of the expression “must be based on” in lieu of “should be based on”.

We note that the application of the principles is developed further within the Rules and the consequent regulatory process. Observation of the broader framework reveals that any discretion on the use of the term “should be based on” is in the hands of the AER, not the NSP, as follows:

- NER clause 6.7.4(a) requires the AER to specify *negotiated distribution service criteria* to be used by the NSP in negotiating prices to be charged for the provision of negotiated distribution services; and
- NER clause 6.7.4(b) requires the *negotiated distribution service criteria* to give effect to and be consistent with the negotiated distribution service principles of NER clause 6.7.1.

In the case of the *negotiated distribution service criteria* specified by the AER for SP AusNet, the AER has determined that the principle discussed in this section, (NER clause

6.7.1(1)) should default to a binding obligation that price be based on costs incurred. In our view, any justifiable departure from a cost based pricing approach should be at the discretion of the AER, and there is no valid reason to not leave open this discretion for the regulator.

2. Assessment framework

From the preceding section it is concluded that the rule change is unnecessary to provide assurance regarding the compliant pricing of negotiated distribution services.

The AEMC's assessment method includes a number of criteria, and this section presents our view of the proposed rule change against each.

- Improved transparency of the CAM: the CAM is a principles based method, in accordance with the Rules. The CAM is necessarily principles based due to the dynamic nature of costs, and accordingly the impact on allocators. It is therefore not clear that improved transparency would be achieved through a consultation process on each NSPs CAM;
- Increased stakeholder engagement regarding amendments: The CAM and any amendments proposed by an NSP are subject to the AER's approval, and inclusion of amendments required by the AER. The CAM cannot depart from the negotiated distributed services criteria. Stakeholder engagement in the process occurs in the development of guidelines, and in the price determination process where the negotiated distribution services criteria are specified by the AER. Consultation on approval of each NSPs CAM would be unlikely to efficiently add further value to the process;
- Increased regulatory burden: The process for establishing an NSP's CAM under the NER is principles based. This is reflective of the varying nature of cost allocators with time. The process makes provision for consultation in the development of guidelines and criteria which govern the establishment of the CAM. The CAM is heavily controlled by these instruments and consultation at the lower level is unnecessary and risks re-litigating issues associated with the guiding instruments. Any revision of the CAM will incur costs in preparation, governance, communication with the AER and other stakeholders and potentially even third party advice to refute arguments from other parties. Given the above arguments against the proposed benefits in terms of transparency and stakeholder engagement, SP AusNet does not consider that any increased regulatory burden can be justified on a cost-benefit basis.
- More efficient prices for network services: The issues of concern to the proponent are addressed through the regulatory process. These include independent audit of financial information by NSPs, due diligence surrounding the submission of regulated accounts to the AER, and the discretion available to the AER in developing the guiding instruments and in approving the CAM. Having regard to these factors it is not clear how customer consultation in assessing compliance of the CAM will facilitate efficient prices. Customer involvement in preceding phases of consultation is appropriate.

3. Conclusion

For the reasons discussed in this submission SP AusNet does not support the rule change request. We conclude that perceived problems are addressed by the regulatory framework surrounding the CAM, to ensure allocation of costs on an efficient basis, and that the proposed rule changes would only lead to more cumbersome process and higher costs for the AER and NSPs.

I would be pleased to respond to any enquiries the AEMC may have regarding this submission.

Yours sincerely,



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