

# Residual Costs and Jurisdictional Instruments

Workshop Two – Cost Reflective Network Pricing  
11 April 2014



**Ben Davis**  
**Adviser**

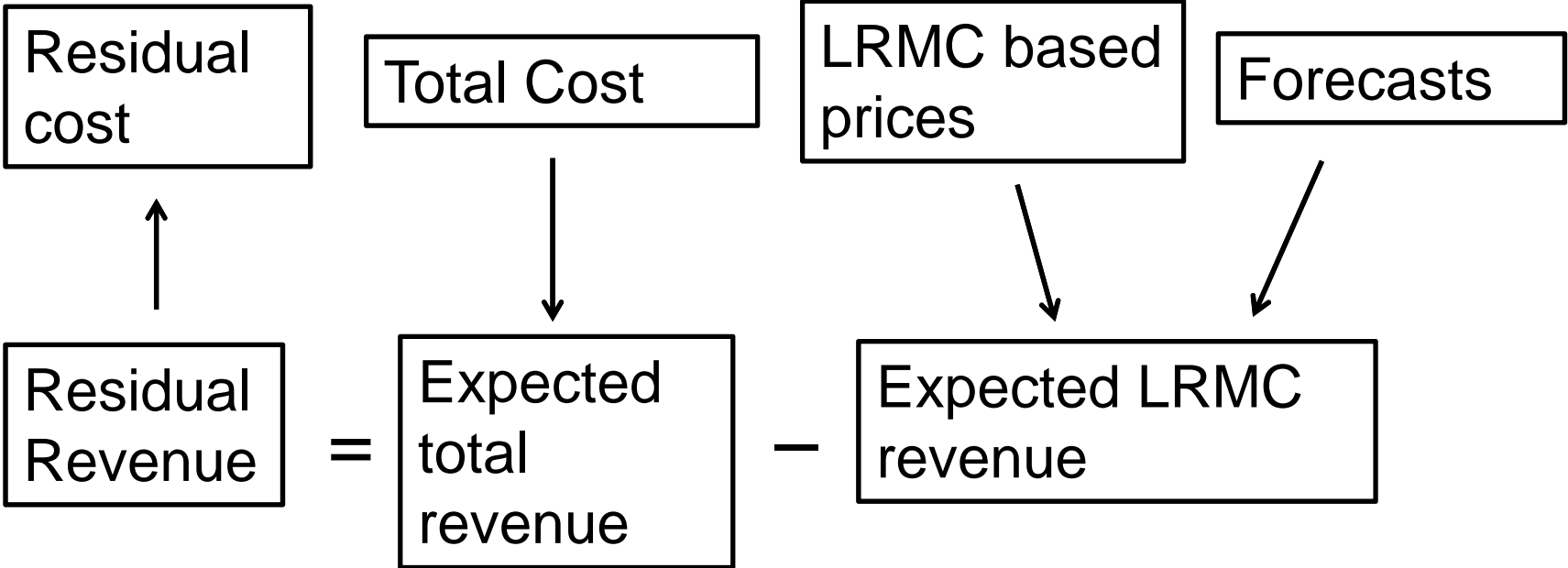
AUSTRALIAN ENERGY MARKET COMMISSION

# Outline

---

- Residual Costs – What are they?
- Residual Costs – Objectives
- Residual Costs – in the NER
- Jurisdictional Instruments – Objectives
- Jurisdictional Instruments – Conflicts with cost reflective network pricing
- Jurisdictional Instruments – Options within the NER

# Residual Costs – What are they?



# Residual Costs – Objectives

---

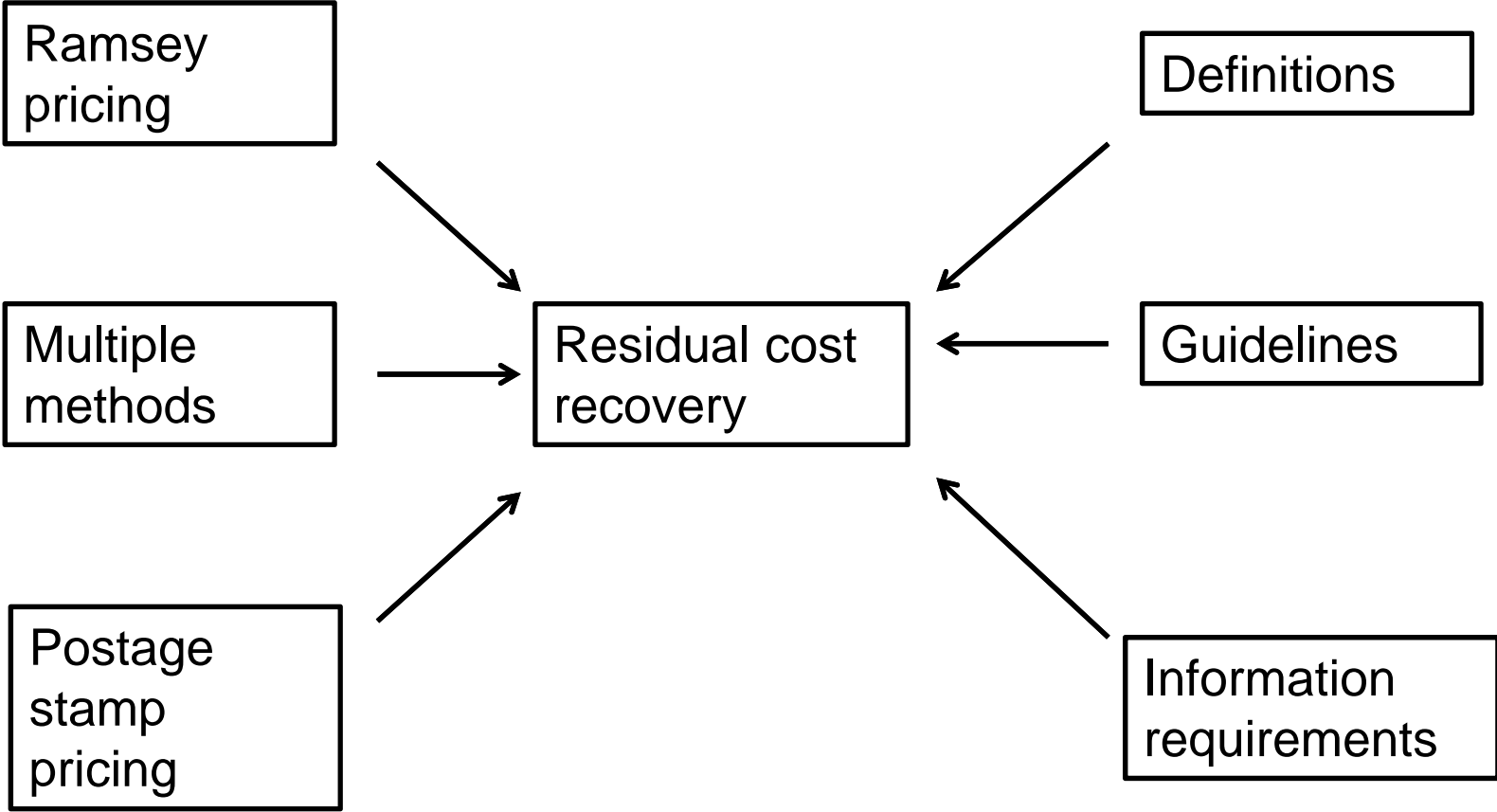
- **Cost recovery**
  - To maintain financial sustainability it is important that DNSPs are able to recover their approved costs.
- **Allocative efficiency**
  - Price increases above LRMC to recover residual costs result in reductions in allocative efficiency.
  - To minimise efficiency losses prices above LRMC should be set to minimise distortion to demand.
- **Customer impacts**
  - Residual costs should be recovered in a way that minimises price shocks and price instability for customers.
- **Jurisdictional instruments**
  - Residual costs must be allowed to be recovered in a way that is consistent with jurisdictional instruments.

# Residual Costs – in the NER

---

- Current Rules
  - LRMC based pricing is not mandatory in the NER. DNSPs are not required to set out the revenue that would be obtained from LRMC based prices. The magnitude of residual costs are unknown
  - Residual costs are to be recovered with “minimum distortion to efficient patterns of consumption”
- SCER proposal
  - Consider Ramsey and postage stamp pricing, other options and combinations of methods
- SCER proposal – take into consideration:
  - allowing for recovery of residual costs in a way that does not distort or undermine flexible pricing, where flexible pricing is available
  - potential impacts on particular classes of consumers
  - and the appropriate balance between potential impacts on particular classes of consumers and efficient pricing

# Residual Costs – in the NER (cont.)



# Jurisdictional Instruments – Conflicts with cost reflective network pricing

---

- Current Rules
  - Jurisdictional instruments are currently not mentioned in the NER.
  - The current pricing principles are not mandatory – no conflict with jurisdictional instruments.
- SCER proposal
  - Explicit inclusion of jurisdictional instruments.
  - Mandatory pricing principles.
  - Likely to cause inconsistencies.
- Potential conflicts
  - Any set of mandatory pricing principles is likely to cause conflicts with jurisdictional instruments.

# Jurisdictional Instruments – Options to address conflict

---

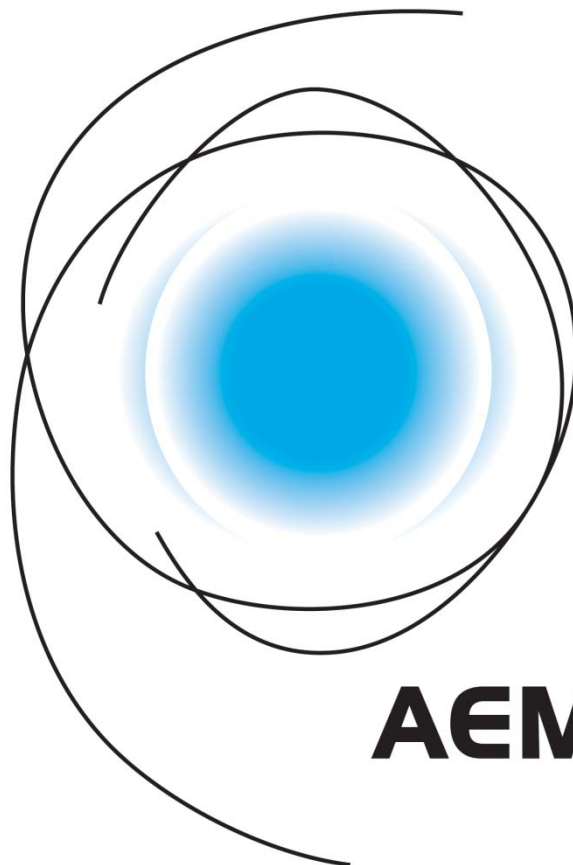
- Recognise supremacy of jurisdictional instruments in the Rules
- Make the pricing principles subject to jurisdictional instruments
  - e.g. DNSPs must comply with the pricing principles “to the maximum extent possible”, subject to jurisdictional instruments



# Jurisdictional Instruments – Information requirements

---

- In considering the options regarding jurisdictional instruments, a key objective is transparency
  - Where variation is made from the pricing principles to incorporate jurisdictional instruments it is important that changes are transparent.
  - If the Rules incorporate such instruments the variations from the pricing principles should be clearly identified.



**AEMC**