Australian Energy Market Commission

RULE CHANGE

DRAFT RULE DETERMINATION

National Electricity Amendment (Recovery of Network Support Payments) Rule 2013

Rule Proponent
SP AusNet

8 August 2013
For and on behalf of the Australian Energy Market Commission

Inquiries

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About the AEMC

The Council of Australian Governments (COAG), through its then Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005. In June 2011, COAG established the Standing Council on Energy and Resources (SCER) to replace the MCE. The AEMC has two main functions. We make and amend the national electricity, gas and energy retail rules, and we conduct independent reviews of the energy markets for the SCER.

Summary of draft rule determination

The Australian Energy Market Commission (AEMC or Commission) makes this draft rule determination in relation to the rule change request from SP AusNet (proponent) regarding the recovery of network support costs. The Commission has decided not to make a draft rule. The Commission considers the current National Electricity Rules (NER or rules) provide appropriate cost recovery mechanisms for network support costs.

Network support service arrangements

A network support service arrangement is a type of non-network solution, which defers the need for a traditional network investment. For example, under this arrangement local (or embedded) generation could be contracted by the network service provider (NSP) to provide a service to address a network constraint. In certain circumstances, a NSP may find it more cost effective to implement a non-network solution to maintain system reliability than expanding its network. Since the non-network solution is recovered through operating expenditure this involves substituting capital expenditure for operating expenditure. The network support costs would be agreed between the network support provider and NSP.

SP AusNet's rule change request relates to network support costs for services that defer:

- distribution network augmentations; and
- investment in transmission-distribution connection assets.[1]

With respect to services that defer investment in transmission-distribution connection assets, SP AusNet considers this is particularly an issue that could arise in Victoria. Under the Victorian electricity distribution licence obligations, Victorian distribution network service providers (DNSPs) are responsible for planning transmission-distribution connection assets.[2]

Cost recovery for network support service arrangements

SP AusNet's rule change request relates to the way in which NSPs recover network support costs. In general, NSPs are able to recover from consumers the NSP's efficient costs of supplying regulated network services. The amount that is able to be recovered is determined through incentive-based regulation. A revenue allowance is determined

1 For example, instead of the DNSP undertaking a distribution network augmentation to maintain distribution system reliability, a DNSP could enter into an alternative non-network arrangement with an embedded generator to provide network support for this.

2 Each Victorian DNSP must comply with the Victorian Electricity Distribution Code under its electricity distribution licence. As part of its licence subject to this Code, the Victorian DNSP is responsible for planning, and directing the augmentation of, transmission-distribution connection assets.

at the beginning of a regulatory control period and NSPs are rewarded or penalised with respect to the allowance to encourage efficient performance.

In some circumstances, costs or projects can be difficult to predict and there would be difficulty in determining an accurate revenue allowance. As a consequence, a stronger form of incentive-based regulation may not work as well. In those specific cases, it may be appropriate to adjust the revenue allowance after it is set. The adjustment is known as a cost pass through. Although the Australian Energy Regulator (AER) still assesses the efficiency of the cost pass through, it can be regarded as a weaker form of incentive-based regulation.

SP AusNet's rule change request seeks to include a new specific pass through in the rules as a cost recovery mechanism for network support costs. This would be in addition to its current cost recovery mechanism through the existing revenue allowance.

Under SP AusNet's proposal, NSPs would be able to seek to recover the above network support costs during a regulatory control period via the specific network support pass through. Currently, specific network support pass throughs are only applicable to the transmission network service providers (TNSPs) for network support service arrangements that defer transmission network augmentations.

Commission's draft rule determination

In deciding not to make a draft rule, the Commission considers that the current regulatory determination process provides an appropriate basis for the recovery of network support costs. This is consistent with incentive-based regulation, which benefits consumers in the long term.

In addition to the regulatory determination process, the rules already provide opportunities to recover certain types of cost pass throughs. Some cost pass throughs are currently specified in the rules, and others can be nominated by a DNSP and accepted by the AER as part of the DNSP's regulatory determination process (referred to in this draft rule determination as "nominated pass throughs"). The existing cost pass through provisions could potentially apply to network support costs.

If the proponent's rule change request were made, it would have had the effect of increasing the number of specific pass throughs that are listed in the rules. Introducing additional cost pass throughs into the rules would weaken the overall incentive-based approach to regulation. The Commission does not consider that treating such costs as a cost pass through, as opposed to relying on the existing cost recovery mechanisms in the rules, would provide sufficiently strong incentives for efficient cost recovery consistent with the National Electricity Objective (NEO) and revenue and pricing principles.

The Commission notes that the AER is able to consider the balance of the incentives between network and non-network solutions, and substitution between capital expenditure and operating expenditure, when determining the appropriate cost

recovery. The AER could use its discretion to adjust these incentives to counter any distortions that might discourage network support service arrangements.

The Commission notes that DNSPs have a specific responsibility for transmission-distribution connection planning in Victoria. However, the current cost recovery mechanisms apply equally to Victorian DNSPs as for other DNSPs in the National Electricity Market (NEM). The Commission does not consider that additional cost recovery mechanisms are required to address the specific arrangements in Victoria.

Therefore, the Commission considers it remains appropriate for network support costs for services that defer investment in distribution network augmentation and transmission-distribution connection assets to be included as part of the overall revenue allowance. That is, any request to recover these costs would be assessed by the AER at the time of the regulatory determination for a given regulatory control period. This means that such costs will be subject to a strong incentive-based framework which best meets the NEO.

The AEMC welcomes submissions on this draft rule determination by 19 September 2013.

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1 SP AusNet's rule change request

1.1 The rule change request

On 17 December 2012, SP AusNet (proponent) submitted a rule change request to the Australian Energy Market Commission (AEMC or Commission) in relation to recovery of costs for network support service arrangements that defer investment in:

- the distribution network; and
- connection assets used to connect a transmission network to a distribution network ("transmission-distribution connection assets").[3]

SP AusNet seeks to be able to recover these network support costs via specific network support pass throughs. It considers this would provide more certainty to network service providers (NSPs) that they can recover these costs, especially during a regulatory control period, and remove bias against the uptake of non-network solutions. It proposes for this rule change to commence immediately so that it can be applied to its existing regulatory determination during the current 2011-2015 regulatory control period.

A network support service arrangement is a type of non-network solution, which defers the need for a traditional network investment. For example, under this arrangement local (or embedded) generation could be contracted by the NSP to provide a service to address a network constraint.

For instance, the network support service arrangement might take the place of augmentation of either the network (such as building additional transmission lines) or transmission-distribution connection assets. Network support costs are costs for providing this service. The network support costs would be agreed between the network support provider and NSP.

1.2 Current arrangements

In respect of costs of providing regulated services, NSPs recover these through one of four main mechanisms:

Cost recovery mechanism	Description
1. Regulatory determination process	• The NSP forecast costs as part of its regulatory proposal • The Australian Energy Regulator (AER) assesses and approves revenue according to criteria in the National Electricity Rules (NER or rules)

3 For the purposes of this draft rule determination, costs for these network support service arrangements will be referred to as "network support costs", unless indicated otherwise.

Cost recovery mechanism	Description
	• The NSP recovers revenue over the regulatory control period
2. Specific pass throughs	• Pass through events listed in the rules • If a pass through event occurs during a regulatory control period, the NSP can apply to the AER to recover costs incurred • The AER assesses according to criteria in the rules
3. Nominated pass throughs	• The NSP may consider an event should be defined as a pass through event and propose this as part of its regulatory proposal • The AER determines whether to accept the pass through event • If the pass though event occurs during a regulatory control period, the NSP can apply to the AER to recover additional costs and the AER must assess according to criteria in the rules
4. Pricing process (distribution network service providers (DNSPs))	• Occurs annually • The AER approves prices which enable DNSPs to recover their allowed revenues under mechanisms 1 to 3 above • Certain specified costs can be included

With respect to network support costs for services that defer transmission network augmentations,[4] there are currently specific pass through arrangements that allow transmission network service providers (TNSPs) to recover these costs, subject to AER approval (mechanism 2 above). However, unlike other specific pass throughs, these costs are not subject to a materiality threshold.[5]

Associated with the specific network support pass through for TNSPs, there is an operating expenditure (opex) roll forward arrangement.[6] This mechanism only applies if a TNSP has made payments under a network support service arrangement in the previous regulatory control period and must continue to make payments under that arrangement in the relevant regulatory control period. Here, the AER must accept the forecast of required opex included in a regulatory proposal in relation to the remainder of costs required to meet obligations under that network support service arrangement in the relevant regulatory control period.

4 These particular network support costs for services that defer transmission network augmentations are referred to as "network support payments" in the rules.

5 With the exception of the specific network support pass through for TNSPs, a materiality threshold currently applies to cost pass throughs. Unless costs incurred due to an event reach this threshold, they cannot be recovered as a cost pass through. The materiality threshold is set at one per cent of the annual revenue requirement (for distribution) or maximum allowed revenue (for transmission).

6 NER clause 6A.6.6(c1).

In relation to network support costs for services that defer distribution network augmentations and transmission-distribution connection assets, these costs may be included in a NSP's regulatory proposal as part of its forecast of expenditure required to provide regulated services (mechanism 1 above). Alternatively, where a network support service is required to respond to a cost pass through event, the AER could consider whether these costs should be recovered as a cost pass through (mechanism 2 or 3 above). The regulatory determination process and nominated pass throughs are discussed further in section 5.3.1.

1.3 Rationale for rule change request

There are two specific issues that the proponent raises:

- DNSPs are unable to recover network support costs for services that defer distribution network augmentations during a regulatory control period in the same way TNSPs can for services that defer transmission network augmentations. That is, DNSPs cannot recover these costs via specific network support pass throughs (including the opex roll forward arrangement); and
- neither DNSPs nor TNSPs are able to recover network support costs for services that defer transmission-distribution connection assets via specific network support pass throughs.

1.3.1 Recovery of network support costs for services that defer distribution network augmentations

With respect to the first issue, the proponent considers:

- DNSPs are not afforded the same level of certainty to recover efficient network support costs as TNSPs;
- the nature of the network support costs makes it difficult for DNSPs to forecast these costs at the beginning of the regulatory control period;
- the current rules are biased towards network solutions over non-network solutions (that is, network support services), and do not treat non-network solutions on an equal footing;
- DNSPs have less incentive to contract network support service arrangements until the next regulatory control period even if these are the lowest cost solutions; and
- DNSPs cannot recover efficient network support costs initiated within the current regulatory control period.

1.3.2 Recovery of network support costs for services that defer transmission-distribution connection assets

With respect to the second issue, this is of particular interest to Victorian DNSPs who are responsible for transmission-distribution connection planning.[7] The proponent considers that DNSPs would be more likely in Victoria to consider non-network alternatives to transmission-distribution connection assets. This includes entering into network support service arrangements that defer investment in these assets.

The proponent considers that similar issues described in section 1.3.1 with respect to network support costs for services that defer distribution network augmentations can also apply to services that defer transmission-distribution connection assets.

1.4 Solution proposed in the rule change request

The proponent's rule change request proposes to amend the rules to:

- allow DNSPs to recover the network support costs for services that defer distribution network augmentations during a regulatory control period via specific network support pass throughs equivalent to that currently available to TNSPs;
- apply the opex roll forward arrangement to DNSPs where network support service arrangements extend beyond one term of a regulatory control period; and
- extend the scope of specific network support pass throughs (which includes the opex roll forward arrangement) to allow for TNSPs and DNSPs to recover network support costs for services that defer transmission-distribution connection assets.

The proponent requests that the rule change commences immediately after the rule is made so that it would apply during the proponent's current 2011-2015 regulatory control period. This would potentially allow an adjustment to its existing revenue allowance for that period.

1.5 Relevant strategic priority

This rule change request relates to the AEMC's strategic priority relating to market arrangements that encourage efficient investment and flexibility. It affects how NSPs can recover their costs which in turn has an impact on NSPs' incentives to invest.

7 See Appendix B for further background information on the Victorian distribution arrangements on transmission-distribution connection planning.

1.6 Commencement of rule making process

On 11 April 2013, the Commission published a notice under section 95 of the National Electricity Law (NEL) advising of its intention to commence the rule making process and the first round of consultation in respect of the rule change request. A consultation paper prepared by the AEMC identifying specific issues or questions for consultation was also published with the rule change request. Submissions closed on 10 May 2013.

The Commission received four submissions on the rule change request as part of the first round of consultation. They are available on the AEMC website.[8] A summary of the issues raised in submissions and the Commission's response to each issue is contained in Appendix A.

1.7 Extension of time

On 27 June 2013, the Commission published a notice under section 107 of the NEL advising of the extension of the period of time for publication of the draft rule determination to 8 August 2013. The extension of time was to allow for further policy analysis to address the issues raised in the rule change request and submissions.

1.8 Consultation on draft rule determination

In accordance with the notice published under section 99 of the NEL, the Commission invites submissions on this draft rule determination by 19 September 2013.

In accordance with section 101(1a) of the NEL, any person or body may request that the Commission hold a hearing in relation to the draft rule determination. Any request for a hearing must be made in writing and must be received by the Commission no later than 15 August 2013.

Submissions and requests for a hearing should quote project number ERC0154 and may be lodged online at www.aemc.gov.au or by mail to:

Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

8 www.aemc.gov.au

2 Draft rule determination

2.1 Commission's draft rule determination

In accordance with section 99 of the NEL, the Commission has made this draft rule determination in relation to the rule proposed by SP AusNet.

The Commission has determined it should not make a draft rule. The reasons are set out in sections 5.3 and 5.4.

2.2 Commission's considerations

In assessing the rule change request, the Commission considered:

- the Commission's powers under the NEL to make the proposed rule;
- the rule change request;
- the fact that there is no relevant Standing Council on Energy and Resources (SCER) Statement of Policy Principles;[9]
- submissions received during first round consultation;
- the Commission's analysis as to the ways in which the proposed rule will not, or is unlikely to, contribute to the National Electricity Objective (NEO); and
- the revenue and pricing principles.

2.3 Commission's power to make the rule

The Commission is satisfied that the proposed rule falls within the subject matter about which the Commission may make rules. The proposed rule falls within section 34 of the NEL as it relates to regulating the activities of persons (including registered participants) participating in the National Electricity Market (NEM) or involved in the operation of the national electricity system (section 34(1)(a)(iii) of the NEL).

2.4 Rule making test

Under section 88(1) of the NEL, the Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the NEO. This is the decision making framework that the Commission must apply.

The NEO is set out in section 7 of the NEL as follows:

9 Under NEL section 33, the AEMC must have regard to any relevant SCER statement of policy principles in making a rule.

"The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to -

(a) price, quality, safety, reliability and security of supply of electricity; and

(b) the reliability, safety and security of the national electricity system."

The key aim of this rule change request is to enable NSPs to recover network support costs during a regulatory control period via specific network support pass throughs. These network support costs relate to services that defer distribution network augmentations and transmission-distribution connection assets.

The Commission is not satisfied that the proposed rule will, or is likely to, contribute to the achievement of the NEO. This is because the current arrangements provide appropriate cost recovery mechanisms for network support costs. These are a combination of the opex allowance approved under the regulatory determination process and potential for cost pass throughs.

2.5 Other requirements under the NEL

In applying the rule making test in section 88 of the NEL, the Commission has taken into account the revenue and pricing principles as required under section 88B of the NEL. The proposed rule relates to matters specified in items 15, 20, 25 and 26D of Schedule 1 to the NEL.

The revenue and pricing principles are set out in section 7A of the NEL. They set out a number of principles that concern matters such as the recovery of efficient costs and incentives to promote economic efficiency.[10]

Under the current regulatory determination process, the NSP is subject to a strong incentive-based framework as part of the overall revenue allowance. This encourages the NSP to forecast as accurately as possible and manage its costs, including network support costs, within its overall revenue allowance. In addition, where a network support service is required to respond to a cost pass through event, then the NSP could apply to the AER to have these costs recovered as a cost pass through. These mechanisms provide sufficient opportunities for NSPs to recover efficient costs consistent with the NEO and revenue and pricing principles.

In particular, the current cost recovery mechanisms:

- provide NSPs with a reasonable opportunity to recover at least the efficient costs that they incur in the provision of regulated services; and
- aim to promote efficiency with respect to the provision of regulated services through the application of effective incentives.

10 NEL sections 7A(2)(a), (3)(a)-(b).

3 Commission's assessment approach

This chapter describes the analytical framework that the Commission has applied to assess the rule change request in accordance with the requirements set out in the NEL (and explained in chapter 2).

In assessing the rule change request against the NEO, we have considered the appropriateness of the current arrangements under the rules.

The fundamental principle of the existing network regulatory arrangements is that an incentive-based regulatory determination process best meets the NEO.[11] Notwithstanding this, there may be circumstances where weaker forms of incentive-based regulation are more appropriate.

With this in mind, in assessing the rule change request against the NEO, the Commission has considered the following factors:

- **Effective incentives**
  - efficiency - incentive-based regulation provides incentives for NSPs to minimise costs, promoting efficient and timely investment, and ultimately lower prices for consumers; and
  - risk management - risks should be allocated to those parties who are best placed to manage them through appropriate financial incentives;
- **Recovery of efficient costs**
  - NSPs should be able to recover costs where they are efficient having regard to the need to incur the costs, given the expected benefits, and minimising the actual costs to deliver a particular benefit; and
- **Proportionality**
  - the implementation and administration costs of the solution needs to be proportionate to the benefits of the solution; and
  - where the current rules appropriately address the problem identified in the rule change request, a rule change would be unnecessary.

The network regulatory framework set out in the rules is designed such that NSPs face incentives to incur only efficient costs associated with providing regulated services. When NSPs meet their service obligations at least cost, productive efficiency is maximised and costs to consumers are minimised.

The NSP's choice on whether to undertake network augmentation to meet its expenditure objectives, or seek network support service arrangements to locate

11 Incentive-based regulation is explained in chapter 4.

embedded generation on its network for example, will affect the cost of meeting those objectives. This in turn will therefore impact upon productive and dynamic efficiency. The extent to which the NSP can choose alternative options for meeting its objectives at potentially lower costs will increase this level of efficiency and minimise costs to consumers.

The NSP may need to trade-off the risk between long term solutions with higher costs and short term solutions with lower costs. A question arises as to whether the current cost recovery arrangements appropriately balance between capital expenditure (capex) incentives for network solutions and opex incentives for non-network solutions.

Regulation should only allow for an "efficient" level of costs to be recovered by NSPs (including a reasonable profit). This is in contrast to allowing all expenditure to be recovered from customers, without any review of whether the level of costs incurred is efficient. Costs are efficient when they are minimised and lower than the value of the benefit they provide. In the case of network investment, the benefit provided may include increased reliability, security, quality or safety of electricity supply.

In addition to providing effective incentives and allowing for recovery of efficient costs, the draft rule needs to be proportionate in its implementation. A draft rule that imposes significant additional administrative costs on NSPs and the regulator may not be justified.

4 Approach to recovery of costs for regulated services

This chapter 4 considers the role of incentive-based regulation and how it should be balanced against regulation that provides regulated businesses with different strengths of incentives in respect of the recovery of their costs. Chapter 4 underpins the Commission's approach to chapter 5, which addresses the recovery of network support costs in greater detail.

4.1 Incentive-based regulation

Incentive-based regulation is an approach that is often applied to regulate natural monopoly businesses, including electricity network businesses in Australia. These electricity businesses became subject to incentive-based regulation which was, in part, to address information asymmetries associated with cost of service regulation.[12]

Under incentive-based regulation, regulated businesses can be rewarded or penalised to encourage efficient performance. This is achieved by specifying a goal as the level of performance and a revenue allowance at the beginning of a regulatory control period. The regulated business is therefore funded to meet that level of performance over the duration of that regulatory control period.

If the regulated business outperforms the revenue allowance during the regulatory control period, it can retain a proportion of its efficiency savings. The remaining benefits would be passed to consumers in the form of lower prices in the long term. As a result, incentive-based regulation allows the regulated business to recover efficient costs and receive a commercial return.

A fundamental part of incentive-based regulation is that the regulator does not approve specific projects. Instead, the regulated business is provided with the discretion as to what projects it undertakes during the regulatory control period and within its maximum allowed revenue.

For example, the regulated business can decide how it manages and reprioritises its expenditure for the provision of services to its customers, such as meeting reliability standards. This encourages the regulated business to become more accountable to its customers, searching for efficiencies that ultimately benefit the regulated business and its customers.

The Commission considers that incentive-based regulation continues to offer a range of benefits which should be preserved in the rules wherever possible. These include:

- accountability - the regulated business has the responsibility to manage how it delivers its service obligations and resources within its allowed revenue;

12 Cost of service regulation involves reimbursing a regulated business for its realised costs.

- efficiency - the regulated business will be financially incentivised to find more efficient ways to operate as it retains some of the savings, while customers benefit from more efficient business practices in the long term;

- efficient risk allocation - the regulated business should bear the risk when forecasting expenditure as it would be in a better position to manage those risks;

- avoiding information asymmetries - since the regulator does not approve individual projects, the regulator has less need to access the regulated business's information; and

- lowering regulatory burden - the regulator has a guiding role for business decision-making and enforcing compliance, without the need for regulatory intervention and detailed project-by-project assessments.

The above benefits of incentive-based regulation promote the NEO. This is because the regulated business is incentivised to make efficient investment decisions and be rewarded for managing its expenditure, while consumers receive some of the benefits. This leads to efficient investment in the provision of services and recovery of efficient costs which would be in the long term interests of consumers.

This approach to incentive-based regulation underpinned the rule changes made by the AEMC in 2012, which are discussed further in section 4.3 below.

4.2 Different degrees of incentive-based regulation

In some cases, it may be appropriate to apply a weaker form of incentive-based regulation. For example, some costs are outside the control of the regulated business, such as taxes or other costs imposed by legislation.

In addition, where costs or projects are difficult to predict, such as projects that depend on an external trigger, there would be difficulty in determining an accurate revenue allowance. As a consequence, a stronger form of incentive-based regulation may not work as well.

In those specific cases, it may be appropriate to reduce the incentives to provide investment certainty. This may involve a greater use of project-by-project assessments and an adjustment of the regulator's regulatory determination during a regulatory control period to apply cost pass throughs.

However, we consider lowering the strength of the incentives should be done only where absolutely necessary, and should not dilute the overall benefits of incentive-based regulation. This is because weakening the effect of incentives would approach a more cost of service based regulatory framework. Such an outcome would result in less focus on rewarding the business for efficiency gains that it achieves or innovation.

Lowering the effect of incentives would also mean consumers have to bear more of the risk of actual costs differing from the forecast. For instance, regulated businesses

would have less of an incentive to manage their expenditure within their overall revenue such as by reprioritising of expenditure between regulatory years.

Another drawback of reducing the incentives is that the regulator would have a greater role in determining whether specific projects can proceed, which is not ideal. Among other things, the regulator would be disadvantaged by information asymmetries. This would require it to second guess the regulated business's individual engineering and asset management decisions.

Finally, increasing the number of regulatory decisions for cost pass throughs outside of the regulatory determination process could increase the administrative burden placed upon the regulator. Adjusting the regulatory determination for cost pass throughs would also lead to a greater degree of uncertainty and variability in annual prices for both regulated businesses and consumers.

4.3 Network regulation rule changes in 2012

The AEMC made rule changes in 2012 that enhanced the approach to incentive-based regulation that has developed over many years in the NEM.[13] Part of these rule changes involved giving the AER greater flexibility to develop incentives for regulated businesses to achieve efficiency. For instance, the AER now has a greater ability to create effective capex incentives and determine an appropriate cost of capital consistent with these incentives.[14]

Relevant to this particular rule change, the AER is able to consider the balance of the incentives between network and non-network solutions, and substitution between capex and opex. To facilitate this, the AER is required to consider principles and factors that it must apply when designing capex incentives through a capex sharing scheme.[15] This involves the AER considering how the scheme would interact with other incentives the business may have, and allows the AER to adjust the relative balance of capex and opex incentives.

The approach that the AER intends to apply under the new network regulation rules made by the AEMC in 2012 will be set out in its guidelines which will be published later in 2013. The AER has stated in the course of its work on these guidelines that it will aim to address any imbalances between capex and opex incentives.[16] For example, it notes that if incentives towards opex were too strong then this could inefficiently result in the use of opex-based non-network solutions in preference to capex-based network solutions.[17] This in turn would lead to inefficient investment decisions.[18] The

13 AEMC, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services*, Final rule determination, 29 November 2012.

14 Ibid, pp. 116-117.

15 NER clauses 6A.6.5A and 6.5.8A.

16 AER, *Better Regulation: Expenditure incentives guidelines for electricity network service providers*, Issues paper, March 2013, pp. viii, 30.

17 Ibid.

18 Ibid.

AER could therefore use its discretion to adjust these incentives to counter such distortions.

5 Cost recovery of network support service arrangements

This chapter 5 considers whether the current cost recovery arrangements for network support service arrangements that defer distribution network augmentations and transmission-distribution connection assets are appropriate.

5.1 Proponent's view

In addition to its rule change request, SP AusNet has provided additional comments in its submission.

With respect to the current arrangements, SP AusNet considers that a non-network option for the Cranbourne Terminal Station could not be selected in 2011.[19] It considers that the rules would have prevented it from recovering these network support costs.[20]

In particular, it interprets from a past AEMC rule determination that these costs could only be recovered through the regulatory determination process and, in certain circumstances, cost pass throughs.[21] Therefore, it considers that Victorian DNSPs would be unable to recover these costs during a regulatory control period until the next regulatory determination process in 2015.[22]

For similar reasons, it does not support nominated pass throughs as a cost recovery mechanism for network support costs.[23] That is, it would not be provided with sufficient certainty of being able to recover these costs during a regulatory control period.[24]

In relation to the Victorian arrangements, it notes that the Victorian DNSP has the impetus to fund network and non-network projects associated with transmission-distribution connection assets.[25] This is especially the case in Victoria because the TNSP does not receive ex ante revenue to fund those projects.[26]

5.2 Stakeholder views

Jemena, CitiPower and Powercor provided submissions to this rule change process. They were supportive of SP AusNet's rule change request for specific network support

19 SP AusNet, Submission on rule change request, 10 May 2013, p. 2.

20 Ibid.

21 Id, pp. 3-4.

22 Id, pp. 3-4, 6.

23 Id, p. 5.

24 Ibid.

25 Id, pp. 6-8.

26 Ibid.

pass throughs, including the opex roll forward arrangement, and provided similar comments.[27]

They note Victorian DNSPs were previously able to recover network support costs under the Essential Services Commission of Victoria (ESCV) regime.[28] However, under the current arrangements, they consider the regulatory determination process and nominated pass through arrangements lack certainty for network support costs to be recovered.[29]

The Victorian DNSPs consider it may be difficult to forecast these arrangements or costs at the beginning of the regulatory control period.[30] There is also not sufficient certainty the AER would approve these, particularly if they span over multiple periods.[31] Further, it would be uncertain that NSPs can recover these costs at all if they fall below the materiality threshold for nominated pass throughs.[32]

Jemena considers efficient costs would only be known later at the regulatory investment test for transmission (RIT-T) or regulatory investment test for distribution (RIT-D) stage.[33] It suggests the rule change would complement the RIT-D process on encouraging non-network options.[34]

Jemena considers that the number of network support service arrangements will continue to be low into the future and therefore recovering network support costs via specific network support pass throughs would not be administratively burdensome.[35] Further, it suggests the AER would still have sufficient regulatory scrutiny of these costs.[36]

On the other hand, CitiPower and Powercor consider that these network support service arrangements will grow and become recurrent.[37] This in turn would necessitate specific network support pass throughs.[38]

The AER has no strong view as to the precise mechanism that should be used for recovery of network support costs.[39] It observes that cost recovery mechanisms

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27 CitiPower and Powercor, Submission on rule change request, 3 May 2013, p. 1; Jemena, Submission on rule change request, 10 May 2013, pp. 4-6.

28 CitiPower and Powercor, Submission on rule change request, 3 May 2013, p. 1; Jemena, Submission on rule change request, 10 May 2013, p. 6.

29 CitiPower and Powercor, Submission on rule change request, 3 May 2013, p. 2; Jemena, Submission on rule change request, 10 May 2013, pp. 1, 4.

30 Ibid.

31 Ibid.

32 Ibid.

33 Jemena, Submission on rule change request, 10 May 2013, pp. 1, 3-4.

34 Ibid.

35 Id, pp. 4-5.

36 Ibid.

37 CitiPower and Powercor, Submission on rule change request, 3 May 2013, pp. 1-2.

38 Ibid.

currently exist, such as the regulatory determination process and nominated pass throughs.[40] If these mechanisms are deemed ineffective in achieving efficient use of network support, the AER considers the proposed rule may need to be made.[41]

5.3 Commission's analysis

5.3.1 Mechanisms for recovery of costs for network support service arrangements

Currently, there are two general mechanisms that are available for NSPs to recover costs associated with network and non-network solutions under the rules:

- regulatory determination process; and
- potentially, cost pass throughs.[42]

This section 5.3.1 covers the following issues:

- whether the two existing cost recovery mechanisms referred to above currently allow for recovery of network support costs associated with services that defer distribution network augmentations and transmission-distribution connection assets; and
- if so, whether these mechanisms are appropriate in light of our approach described in chapter 4 of this draft rule determination.

Regulatory determination process

NSPs are subject to regulatory control periods, which are usually five years. For each period, the AER makes regulatory determinations on the annual revenue requirements that DNSPs are entitled to for providing standard control services and TNSPs for providing prescribed transmission services. These services may be sourced from network or non-network solutions.

As part of the regulatory determination process, the NSP submits its regulatory proposal which includes forecast expenditure that it estimates it would need in order to meet its expenditure objectives over that regulatory control period. The AER considers the NSP's forecast expenditure and assesses whether it reasonably reflects efficient and prudent costs based on realistic estimates of forecast demand and cost inputs. As a result of the regulatory determination process, the AER approves the total revenue allowance which the NSP can recover over the regulatory control period.

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39 AER, Submission on rule change request, 17 May 2013, pp. 1-2.

40 Ibid.

41 Ibid.

42 With respect to cost pass throughs, we specifically consider the nominated pass through as it has been raised in submissions.

With respect to network support costs for services that defer network augmentations and transmission-distribution connection assets, all NSPs including Victorian DNSPs can currently seek to recover these costs, provided they meet the expenditure objectives. These would be recovered as part of their total revenue allowance determined at the beginning of the regulatory control period under the regulatory determination process. The AER must assess the NSP's proposal based on criteria under the rules. If the revenue is approved, the NSP may decide to use this to fund a network support service arrangement during the regulatory control period.

Victorian DNSPs claim that these network support costs can be difficult to forecast and lack certainty that the AER would approve them at the beginning of the regulatory control period.[43] We consider that these costs are not sufficiently different to other costs which can be difficult to forecast at the time of the regulatory determination. Therefore, we do not consider that the network support costs should be treated differently and recovered outside of the usual regulatory determination process.

Inclusion of these costs as part of the revenue allowance creates incentives for NSPs to achieve efficiency throughout the regulatory control period. Such an approach promotes the NEO.

Nominated pass throughs

As part of the regulatory determination process, the AER can approve categories of events nominated by NSPs as cost pass throughs.

In making its decision on whether a proposed category of event should be a cost pass through event, the AER must consider certain factors listed in the rules:[44]

- whether the event proposed is an event covered by a category of cost pass through event specified in the rules;
- whether the nature or type of event can be clearly identified at the time the determination is made for the NSP;
- whether the NSP could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event;
- whether the NSP could insure against the event, having regard to:
  - the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or
  - whether the event can be self-insured on the basis that:

43 CitiPower and Powercor, Submission on rule change request, 3 May 2013, p. 2; Jemena, Submission on rule change request, 10 May 2013, pp. 1, 4.

44 Definition of "nominated pass through event considerations", Chapter 10 of the NER; AEMC, *Cost pass through arrangements for Network Service Providers*, Final rule determination, 2 August 2012, p. 20.

(i) it is possible to calculate the self-insurance premium; and

(ii) the potential cost to the NSP would not have a significant impact on the NSP's ability to provide network services; and

- any other matter the AER considers relevant and which the AER has notified NSPs is a nominated pass through event consideration.

If a particular category of event proposed by the NSP is defined by the AER as a cost pass through event, then the NSP may apply for a cost pass through in respect of costs incurred as a result of such an event during the regulatory control period. If the costs meet the materiality threshold,[45] the AER is required to undertake an economic assessment of these applications within a specified timeframe.[46] If the AER decides to approve these costs, then these costs would be passed onto the NSP's customers in subsequent regulatory years.

Where the AER approves costs as a result of a cost pass through event occurring, these should represent a *change* in costs compared to what the AER allowed in the most recent regulatory determination. That is, where the NSP already recovers for some of the costs this should be taken into account. This is particularly relevant where a NSP originally sought to address a network constraint through a network solution and was allowed to recover for capex as a result. If the NSP subsequently decides to address the constraint through a non-network solution such as network support, it will continue to recover the original capex regardless of whether the AER approves a cost pass through amount for costs associated with the non-network solution.

Conclusion

We consider that the regulatory determination process is the primary and most appropriate mechanism for NSPs to seek to recover network support costs for services that defer distribution network augmentations and transmission-distribution connection assets.

The regulatory determination process encourages NSPs to forecast costs to the extent possible at the beginning of the regulatory control period and to manage their expenditure within their allowed revenue during the regulatory control period. In other words, NSPs are incentivised to make efficient investment decisions and recover efficient costs, which benefit consumers in the long term. As such, recovering these costs under the regulatory determination process is consistent with the NEO.

In some circumstances, it may be appropriate for NSPs to recover network support costs outside of the regulatory determination process. These would be subject to AER approval as cost pass throughs. The AER may require such cost pass throughs to be based on events which are unforeseeable at the time of the regulatory determination. If

45 The materiality threshold in transmission is one per cent of the maximum allowed revenue (MAR), while in distribution it is one per cent of the annual revenue requirement.

46 The AER has a standard 40 business days (with the ability to extend this time for complex matters) to confirm the cost pass through event and the amount to be passed through to consumers.

this is the case, network support costs would more appropriately constitute a response to an event, rather than the entry into the network support service arrangement itself being the relevant cost pass through event. Recovering these costs in this way would be at the AER's discretion and subject to certain criteria set out in the rules.

On the basis that there are already appropriate mechanisms available to NSPs to recover the costs which are the subject of the rule change request, we do not consider that there should be an additional specific network support pass through as proposed by the proponent.

In addition, we note that the rule change request seeks to allow Victorian DNSPs to recover these types of costs in the current regulatory control period; that is, before the next regulatory determination in 2016. We are generally cautious in making rule changes that would have the effect of revisiting specific decisions made by the AER in regulatory determinations during an existing regulatory control period. If a rule change was to be made and commence immediately as requested, it would detract from the certainty of having a revenue allowance determined for a given regulatory control period.

5.3.2 Victorian arrangements

We recognise that the Victorian electricity distribution licence obligations create a specific arrangement in Victoria in which Victorian DNSPs are responsible for transmission-distribution connection planning.[47] On this basis, SP AusNet considers Victorian DNSPs are the appropriate bodies to fund network and non-network solutions associated with these types of projects.[48]

Despite these Victorian arrangements, we consider that the current cost recovery mechanisms discussed above apply in an equivalent way to Victorian DNSPs. That is, if a Victorian DNSP expects to enter into a network support service arrangement, it should seek recovery of the associated network support costs through the regulatory determination process, or possibly as a solution to a cost pass through event.

5.4 Commission's draft assessment of the current arrangements

Consideration of the assessment criteria identified in chapter 3 indicates that making the proposed rule would not contribute to the NEO. In particular:

- the regulatory determination process provides appropriate incentives for NSPs to minimise their expenditure, including determining the efficient trade-off between opex and capex. Under this process, NSPs are financially rewarded in forecasting their expenditure as accurately as possible, bearing the risks of uncertainty and inaccurate forecasting, and managing their expenditure within their allowed

47 See Appendix B for further background information on the Victorian distribution arrangements on transmission-distribution connection planning.

48 SP AusNet, Submission on rule change request, 10 May 2013, pp. 6-8.

revenue during a regulatory control period. This allows efficient costs to be recovered, while incentivising NSPs to minimise their costs, which benefits consumers in the long term;

- the NSP's ability to choose an appropriate network or non-network solution and make efficient investment decisions is not hindered by the current cost recovery arrangements. Under the incentive-based regulatory determination process, the AER has the discretion to balance incentives for capex-driven network solutions and opex-driven non-network solutions; and
- as the regulatory determination process allows for appropriate recovery of network support costs, it would not be proportionate to create new mechanisms. If the rule change were made, it would also create additional administrative costs.

5.5 Commission's draft decision

We have decided that making the proposed rule would not contribute to the achievement of the NEO. This is because the current rules provide the appropriate framework for recovery of network support costs for services that defer distribution network augmentations and transmission-distribution connection assets.

Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
capex	capital expenditure
Commission	See AEMC
DNSP	distribution network service provider
ESCV	Essential Services Commission of Victoria
MAR	maximum allowed revenue
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
NSP	network service provider
opex	operating expenditure
proponent	SP AusNet
RIT-D	regulatory investment test for distribution
RIT-T	regulatory investment test for transmission
rules	See NER
SCER	Standing Council on Energy and Resources
TNSP	transmission network service provider

A Summary of issues raised in submissions

Stakeholder	Issue	AEMC Response
AER	Agrees in-principle with minimising the barriers to the use of network support. Previously noted the regulatory determination process and nominated pass throughs could address cost recovery issues for network support costs. Considers that the RIT-D and capex incentive schemes will incentivise the uptake of network support service arrangements. If the cost recovery mechanisms and incentive arrangements are not effective in achieving efficient use of network support, the AEMC may wish to consider the best solution consistent with its recent reviews. However, the AER does not have a strong view on which mechanism should be used so long as it best promotes the NEO and is at least cost to consumers. (pp. 1-2)	We do not consider that the current cost recovery arrangements act as a barrier against non-network solutions. The current cost recovery mechanisms are impartial as to whether the expenditure is for network or non-network solutions. The current regulatory determination process in particular best promotes the NEO which is in the long term interests of consumers, while allowing the AER to assess network support costs which have been forecast.
CitiPower and Powercor	Do not support nominated pass throughs because it is subject to uncertainties of AER discretion, especially where the network support service arrangements cross over multiple regulatory control periods. Also, do not consider a materiality threshold should apply to this because network support costs would likely be less than $5m. (p. 2)	In some circumstances, it may be appropriate for NSPs to recover network support costs as part of an approved cost pass through amount. If this is the case, network support costs would more appropriately constitute a response to a cost pass through event, rather than the entry into the network support service arrangement itself being the relevant cost pass through event. We consider that network support costs are not sufficiently different to other costs which can be subject to AER discretion and materiality threshold associated with cost pass throughs. Therefore, we do not consider that network support costs should be treated differently from other costs.
CitiPower and Powercor	Accepts that network support costs should ideally be recovered through the regulatory determination process, which would be consistent with incentive-based regulation. However, considers that it	With respect to the issue of uncertainty associated with forecasting these network support costs and approval by the AER at the regulatory determination stage, we

Stakeholder	Issue	AEMC Response
	is not always possible to forecast the need for these costs during the regulatory determination process, and there is not sufficient certainty the AER would approve these costs at that time. The rules should be flexible to allow for a specific network support pass through. This would also take into account expected future increases in these arrangements and their recurrent nature. (pp. 1-2)	consider that these network support costs are not sufficiently different to other costs which can be difficult to forecast at the time of the regulatory determination. Therefore, the primary mechanism for recovering these costs should be the usual regulatory determination process.
CitiPower and Powercor	Do not consider the current rules provide DNSPs with the ability to recover network support payments to allow efficient deferral of transmission-distribution connection augmentation. (p. 1)	We do not accept this. Under the current regulatory determination process in particular, these network support costs may be recovered. This means that such costs will be subject to a strong incentive-based framework under the overall revenue allowance.
Jemena	Considers the number of network augmentation projects for network support would be small, noting the existence of only the Somerton Power Station project which deferred construction of the Tullamarine terminal station. Believes the number of projects will continue to be low and not create an administrative burden on the AER to assess these during the regulatory control period. (p. 5)	Given that we consider the current cost recovery mechanisms are appropriate, we consider administrative costs does not become an issue for this draft rule determination.
Jemena	If DNSPs could recover network support costs via specific network support pass throughs and opex roll forward arrangement, network support solutions would be promoted as efficient non-network alternatives, and the AER would still have regulatory scrutiny and approval over these costs. However, there would be less risk to recovery of network support costs than under the current arrangements. The opex roll forward arrangements would also allow for ongoing network support payments in future regulatory control periods and would incentivise use of the network support service arrangements. (pp. 4-5)	With respect to promoting network support service arrangements, see our response to the AER's comment above. With respect to the appropriate recovery mechanism for these network support costs, see our response to CitiPower and Powercor's comment above. With respect to the opex roll forward arrangements, this was designed to address imbalances between capex-related network solutions and opex-related non-network solutions in the transmission network regulation. Following the network regulation rule determination in 2012, the AER has stated that it will aim to address any

Stakeholder	Issue	AEMC Response
		imbalances between capex and opex incentives that would lead to inefficient investment decisions. Therefore, the AER can use its discretion to adjust these incentives to counter such distortions.
Jemena	Currently DNSPs can recover network support costs at the time of the regulatory determination. However, the regulatory determination process is not effective for network support costs because they are difficult to forecast at the time of the regulatory determination process, and the most efficient solution would only be known at the RIT-T or RIT-D stage. (pp. 1, 4, 6)	With respect to the DNSP's difficulty in forecasting these network support costs at the regulatory determination stage and whether they are efficient, see our responses to CitiPower and Power's comments above.
Jemena	Although nominated pass throughs allow for costs to be recovered during a regulatory control period, the materiality threshold makes it not ideal and would act as a barrier to network support solutions where costs are below that threshold. For Jemena, its costs would be $2m. (pp. 1, 4)	With respect to nominated pass throughs, see our response to CitiPower and Powercor's comment above. With respect to promoting network support service arrangements, see our response to the AER's comment above.
Jemena	Allowing for a cost pass through for recovery of network support costs would support the RIT-D rule change. That rule change was designed to enable non-network providers to propose non-network options. (p. 3)	We consider that the current cost recovery mechanisms for these network support costs do not conflict with the RIT-D rule change.
Jemena	The rule change should commence immediately to maximise the benefit to customers. It is not aware of any other transitional or jurisdictional requirements that will be impacted by the rule change. (p. 7)	As a draft rule has not been made, commencing the rule change immediately does not become an issue for this draft rule determination.
Jemena	The problem with respect to recovery of network support costs only under the regulatory determination process is an issue for all DNSPs. However, it is more severe in Victoria because of their licence requirements for planning transmission-distribution connection assets. Victorian DNSPs were previously able to recover network	Despite the Victorian arrangements, we consider that the current cost recovery mechanisms are appropriate for all DNSPs and TNSPs to recover these network support costs. The current cost recovery mechanisms apply in an equivalent way to Victorian DNSPs. See our response to

Stakeholder	Issue	AEMC Response
	support costs for services that defer transmission-distribution connection assets via the annual pricing process under the ESCV. Applying specific network support pass throughs for these arrangements to TNSPs only does not resolve the Victorian problem. (pp. 2, 6)	CitiPower and Powercor's comment above. With respect to specific network support pass throughs, see our response to CitiPower and Powercor's comment above.
SP AusNet	Agrees with the assessment framework. However, the definition of efficient costs should be the lowest cost option, and not limited to those that are lower than the value of the benefit they provide. (p. 2)	We do not accept this. NSPs should be able to recover costs where they are efficient by keeping prices close to long term costs of production and less than the value of benefits they provide.
SP AusNet	Considers that there are similarities between DNSPs and TNSPs with respect to network support service arrangements in terms of degree of uncertainty in seeking recovery of costs and low number of arrangements. Project sizes only vary between deferral of distribution and transmission network augmentations, while deferral of transmission-distribution connection assets would be the same. (p. 5)	As set out above, we consider the existing cost recovery mechanisms available to DNSPs are appropriate.
SP AusNet	SP AusNet submitted the rule change in response to network support costs that were not recoverable under the rules for the Cranbourne Terminal Station in February 2011. Further, previous to the December 2011 "Network Support Payments and Avoided TUoS for Embedded Generators" rule change, SP AusNet was able to recover these costs via annual pricing. Although need for such a network support service arrangement has been postponed based on revised forecast demand, current demand forecasts indicate it would be an economic option at this location before the end of the current regulatory control period. (pp. 2-4)	We note that SP AusNet identifies the network support service arrangement for the Cranbourne Terminal Station as a deferral of transmission-distribution connection assets. With respect to SP AusNet's concern that it is unable to recover these network support costs, we consider that the current cost recovery mechanisms provide the appropriate means for SP AusNet. If there are ongoing payments for forthcoming regulatory control periods associated with this network support service arrangement, then SP AusNet should seek to recover these costs at its next regulatory determination.
SP AusNet	A need for network support service arrangements could vary between once in five years to once a year. For an arrangement	We note the potential varying frequency of network

Stakeholder	Issue	AEMC Response
	similar to Bairnsdale (expires in 2020 and recovered via the annual pricing), it is once every 15 years. (pp. 2-4)	support service arrangements for Victorian DNSPs.
SP AusNet	Materiality of the problem should not be a key consideration for this rule change because of the recent development of network support which should not be discouraged. With the increase in DSP projects including network support in the future, it will likely become material. Network support service arrangements would be more material to network support providers as NSPs have to decide whether to enter into these arrangements. (p. 3)	Given that we consider the current cost recovery mechanisms are appropriate for these network support costs, we consider that materiality of the problem does not become an issue for this draft rule determination. With respect to promoting network support service arrangements, see our response to the AER's comment above.
SP AusNet	Allowing DNSPs to use a specific network support pass through mechanism would ensure that they are able to recover efficient network support costs. The AER would still be able to scrutinise these costs, while reducing the risk of cost recovery that would discourage network support service arrangements even where they are efficient. (p. 4)	With respect to specific network support pass throughs for DNSPs, see our response to CitiPower and Powercor's comment above. With respect to promoting network support service arrangements, see our response to the AER's comment above.
SP AusNet	Prefers specific network support pass throughs over nominated pass throughs because: it could be applied before the next regulatory control period; increases certainty for cost recovery of such costs over multiple periods; it could apply to both TNSPs and DNSPs at the same time; and the AER has more time to assess the application. (p. 5)	With respect to specific network support pass throughs for DNSPs and nominated pass throughs, see our response to CitiPower and Powercor's comments above.
SP AusNet	An opex roll forward arrangement would address imbalances between the opex and capex incentives. Given network support service arrangements may span over multiple regulatory control periods, this imbalance arises where capex for a network solution would be automatically rolled into the RAB if it has not been overspent, while the efficiency of opex for a non-network solution has to be assessed by the AER at the beginning of each regulatory	With respect to the opex roll forward arrangements, see our response to Jemena's comment above.

Stakeholder	Issue	AEMC Response
	control period. (p. 4)	
SP AusNet	The impact on the rate of return for investors is likely to be negligible compared to the benefits of the rule change if it commenced immediately. This is because of the low network support cost relative to the total expenditure. Therefore, the benefits of customers receiving cost savings sooner would outweigh delaying the rule change. Further, SP AusNet would be able to proceed with its network support service arrangements immediately. (pp. 7-8)	As we have determined not to make a draft rule, the issues concerning rate of return impacts and commencing the rule change immediately are not an issue.
SP AusNet	Does not support DNSPs being limited in recovery of network support costs to the revenue allowance because of: difficulty in forecasting these costs; costs cannot be recovered via prescribed exit service charges; and additional costs arising during the current regulatory control period cannot be recovered. Currently, Victorian DNSPs would have to wait until 2015 to seek such costs to be recovered. (pp. 3-4, 6-7)	With respect to the appropriate cost recovery mechanism for these network support costs, see our response to CitiPower and Powercor's comment above. With respect to the Victorian arrangements, see our response to SP AusNet's comment above.
SP AusNet	The rule change would be consistent with the RIT-D rule change, which introduced demand side engagement obligations on DNSPs, including network support. (p. 3)	With respect to the RIT-D rule change, see our response to Jemena's comment above.
SP AusNet	In Victoria, the DNSP (as opposed to the TNSP) enters into network support service arrangements that defer transmission-distribution connection assets. Therefore, SP AusNet considers the DNSP should directly recover these costs from their customers and bear the risk of this. (p. 6) The current rules provide a different basis for cost recovery of network and non-network solutions associated with transmission-distribution connection assets during a regulatory control period. While the network solution costs would be recovered as a prescribed exit service charge via annual pricing, the non-network option cannot	With respect to the Victorian arrangements, see our response to SP AusNet's comment above. With respect to the appropriate cost recovery mechanism for these network support costs, see our response to CitiPower and Powercor's comment above.

Stakeholder	Issue	AEMC Response
	be recovered at all. (pp. 6-7) In the case of Victoria, as the DNSP cannot recover these costs as a prescribed exit service charge (compared to the network option), it has no means to recover the costs from the TNSP which does not form part of the existing revenue determination. (p. 6) However, the ability to recover costs for network support service arrangements that defer transmission-distribution connection assets and distribution network augmentations via the regulatory determination is an issue across the NEM. For DNSPs in particular, they do not receive the same level of certainty as TNSPs for network support service arrangements that defer network augmentation. (p. 7)	

B Victorian arrangements for transmission-distribution connection assets

Under the Victorian electricity distribution licence obligations, Victorian DNSPs are responsible for planning and directing both new, and upgrades to, transmission connection assets.[49] Under these licence obligations, "transmission connection assets" are defined as "those parts of an electricity transmission network which are dedicated to the connection of customers at a single point, including transformers, associated switchgear and plant and equipment".[50]

On the other hand, under the rules "network" is defined as:[51]

> "The apparatus, equipment, plant and buildings used to convey, and control the conveyance of, electricity to customers (whether wholesale or retail) excluding any *connection assets*. In relation to a *Network Service Provider*, a *network* owned, operated or controlled by that *Network Service Provider*."

where "connection assets" are:[52]

> "Those components of a *transmission or distribution system* which are used to provide *connection services*."

and a "connection service" is:[53]

> "An *entry service* (being a service provided to serve a *Generator* or a group of *Generators*, or a *Network Service Provider* or a group of *Network Service Providers*, at a single *connection point*) or an *exit service* (being a service provided to serve a *Transmission Customer* or *Distribution Customer* or a group of *Transmission Customers* or *Distribution Customers*, or a *Network Service Provider* or a group of *Network Service Providers*, at a single *connection point*)."

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49 Essential Services Commission, Electricity distribution code, May 2012, Version 7; Essential Services Commission, Electricity distribution licence for CitiPower, as varied on 31 August 2005, clause 14; Essential Services Commission, Electricity distribution licence for Jemena, as varied on 24 September 2008, clause 14; Essential Services Commission, Electricity distribution licence for Powercor, as varied on 31 August 2005, clause 14; Essential Services Commission, Electricity distribution licence for SPI Electricity, as varied on 14 January 2005, clause 14; Essential Services Commission, Electricity distribution licence for United Energy Distribution, as varied on 14 January 2005, clause 14.

50 For example, Electricity distribution licence for SPI Electricity Pty Ltd, as varied on 14 January 2005, Schedule 1, clause 1.

51 Definition of "network", NER Chapter 10.

52 Definition of "connection assets", NER Chapter 10.

53 Definition of "connection service", NER Chapter 10.

These definitions indicate that there could be differences between "transmission connection assets" under the Victorian electricity distribution licence obligations and "connection assets" under the rules.

As part of transmission-distribution connection planning, Victorian DNSPs jointly plan with the Australian Energy Market Operator (AEMO) to identify a constraint and options to address the constraint. Once the preferred option is identified, the DNSP enters into a contract with the transmission-distribution connection service provider such as SP AusNet (transmission).

If it provides a prescribed exit service, SP AusNet (transmission) levies the prescribed exit service charges to its customers including the DNSPs. DNSPs in turn would recover these costs from their customers via the annual pricing process.

Where a transmission-distribution connection requires consequential shared transmission network augmentation, this must be directed or authorised by AEMO. This is because AEMO has declared network functions to plan, authorise, contract for and direct augmentation of the declared shared transmission network in Victoria.[54]

We understand that there are different funding arrangements in Victoria compared to other jurisdictions with respect to ex ante revenue allowed for transmission-distribution connection assets, including non-network alternatives. Where the TNSP in Victoria would not receive such an allowance, TNSPs in other jurisdictions would receive this funding as part of their revenue allowance and recover these costs.[55]

As discussed in chapter 5, the cost recovery for the provision of standard control services for Victorian DNSPs, including network support costs, are no different to those for other DNSPs in the NEM.

54 NEL section 50C(1)(a).

55 SP AusNet, Submission on rule change request, 10 May 2013, pp. 6-8.