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**Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235**

Re: AEMC Draft Determination – Changes to Cost Allocation Method (ERC0150)

We appreciate the efforts and process conducted by the AEMC and the submissions to the referenced Rule change Request which sought:

1. adoption of the distribution consultation procedures for changes to CAMs
2. inclusion of numeric values for each cost allocator in the CAM, and
3. Requiring that negotiated distribution service prices 'must be' based on the cost of supplying those services.

We provide the following in response to the Draft Determination (DD). Whilst many of our comments may more appropriately be require consideration by the AER, we have provided them to provide insight to the opportunity provided by the Negotiated Distribution Service classification (including the CAM) to assist in:

- delivering outcomes consistent with the National Electricity Objective (NEO), and also
- Consumer engagement with DNSP's as currently being sought by the AER

Items 1 and 2

For items 1 and 2, it is reasonable a DNSP should have discretion to construct its CAM in light of its own business characteristics and practices provided it is consistent with the National Electricity Objective (NEO).

The AEMC advised in its Draft Determination's (DD) Summary that there were "numeric allocators outside of the cost allocation method." This is not our understanding with regard to the CAM as they are not provided to consumers via the AER's regulatory price determination process. As such, there is no transparency of these allocators to consumers.

The DD on page 17 states "*information is not required by customers to be able to confirm compliance*".

We submit to the AEMC that NER 6.7.3 establishes a requirement for the DNSP to demonstrate pursuant to the NF:

- "(i) to identify and inform a Service Applicant of the reasonable costs and/or the increase or decrease in costs (as appropriate) of providing the negotiated distribution service; and*
- (ii) to demonstrate to a Service Applicant that the charges for providing the negotiated distribution service reflect those costs and/or the cost increment or decrement (as appropriate); and*
- (iii) to have appropriate arrangements for assessment and review of the charges and the basis on which they are made,"*

In its submission the AER commented:

"The Rules, however, already establish a negotiation framework under which DNSPs must provide cost information and demonstrate how proposed prices reflect those costs." (our underline)

As established in our Rule change Request, without numeric allocators in the CAM it is problematic not only for the DNSP to demonstrate compliance, but also for consumers being able to establish that the DNSP's price offer is compliant particularly with regard to overhead allocation, which may represent 25% or more of the cost of a service.

In its Draft Determination (DD), regarding the CAM the AEMC advised:

"Essentially it is a set of instructions to convert the statutory accounts (corporate reporting) into the regulatory accounts (for compliance with the economic regulatory framework)."

The NEO promotes efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to a number of factors, including price.

The question we raised is without any numeric allocators against service aspects contained in a DNSP's CAM, how can consumers assess if prices established pursuant to a DNSP's CAM have been established consistent with the NEO?

We therefore proposed NER 6.15.2(4) to be revised.

"(4) any cost allocation method which is used, the reasons for using that method and the numeric quantity ~~(if any)~~ of the chosen allocator must be clearly described;

In section A2 of its DD the AEMC states:

"The regulatory determination process is highly dependent on the cost allocation method. This is because the revenues for direct control services are related to the costs that are attributed to providing those services." (our underline)

We submit that the CAM represents an integral part of establishing prices for all classifications, and is required by consumers for meaningful consideration of the DNSP's regulatory proposal pursuant to the process in NER Chapter 6 Part E.

We note submissions from the Government of South Australia, the Local Government Association of SA and the Western Sydney Region of Councils supporting the inclusion of numeric allocators. Combined these organizations represent around 3 million "consumers".

In its Summary the AEMC stated:

"the wide publication of numeric values of allocators is unlikely to yield material benefits since the size of negotiated distribution services is small, and customers can request this information as part of a negotiation."

If the publication of numeric values of allocators applied only to services pertaining to Negotiated distribution services we agree with the AEMC that the benefit would be limited. However, it was our intention in proposing the Rule change that numeric allocators were to be applied to all service classifications (and therefore all consumers), not simply Negotiated distribution services where consumers may be able to request this information as part of a negotiation.

As consumers have not been provided the opportunity to assess any numeric cost allocators it is unclear how any potential value has been attributed to such an assessment or how the AEMC determined in its DD Summary that:

"The costs to DNSPs and the AER of including numeric allocators as part of revised cost allocation methods are likely to outweigh any potential benefits."

Whilst the AEMC has assessed adopting the rule change as proposed will introduce extra costs and disproportionate regulatory burden. Whilst this may be the case, we are not aware that the cost for undertaking such a process has been established.

As consumers have not been provided the opportunity to assess any numeric cost allocators, it is unclear how the AER has formed a view there may be "little identifiable benefit"? Our view is this remains to be determined, particularly if all service classifications are considered.

We also note the AER's submission:

"Publication of separate cost allocator schedules is more workable, but would still incur additional costs for little identifiable benefit."

This is a good initiative from the AER as whilst the AER may already have access to this information consumers do not.

The AER's publication of a (numeric) cost allocator schedule potentially has significant merit as it would provide additional information to consumers and we propose this to the AEMC for consideration, and a potentially lower cost option.

In this regard, even if a schedule was published in the consultation stages (NER Chapter 6 Part E) of each regulatory price determination process, it would assist consumers in assessing how distributor's total costs are being allocated to all distributor service classifications, something which is not available in the current price determination process.

Item 3

The AEMC's DD and submissions regarding this item require consideration, including the Negotiated Distribution Services (NDS) classification in general. Whilst our views may be more appropriate for inclusion in future AER price determination processes, we have provided our general views on several aspects below for consideration by the AEMC.

1. Light Handed Regulation?

The AEMC states in its Summary and in numerous other instances regarding NDS that a "lighter handed regulation is appropriate".

We are not aware of any such required regulatory approach towards NDS under the NERs.

Pursuant to NER 6.2.7 NDS are regulated in accordance with NER Chapter 6 Part D where specific pricing criteria are required to be established in the determination process.

The critical, and indeed only, aspects for the AER's consideration in the NDS process are the DNSP's CAM and Negotiation Framework (which includes the Pricing Criteria). Indeed, once the AER has accepted the DNSP's CAM and Negotiation Framework the AER has no role in NDS pricing, unless it is required to resolve a dispute.

2. NDS Definition and Classification (including DD item 4.1)

The NDS classification has not been subjected to a high level of scrutiny as most DNSP's have few (if any) NDS. The NEL definition of NDS is as follows:

"NEL 2C—Meaning of negotiated network service

A negotiated network service is an electricity network service—

(a) that is not a direct control network service; and

(b) that—

(i) the Rules specify as a negotiated network service; or

(ii) if the Rules do not do so, the AER specifies as a negotiated network service in a distribution determination or transmission determination."

In section A1 of its DD the AEMC states:

"Negotiated distribution services are a category of services for which the parties can negotiate the terms and conditions for services, including price. This is in contrast to direct control services for which the Australian Energy Regulator (AER) determines the maximum price that a DNSP can charge for a particular service." (our underline)

In section 6.3.1 of its DD the AEMC states:

"Negotiated services are a lighter-handed form of regulation because they are assessed by the AER as having being provided with a greater level of competitive discipline, compared with monopoly services. In this case, the presumption is that the negotiating party will have sufficient countervailing power in terms of the substitutes available to it or will have sufficient information on the costs of providing the service such that the provider will be constrained from exercising monopoly power." (our underline)

In section 4.1 of its DD the AEMC states:

"The AER classifies a service according to the form of regulation factors. Direct control services are used where the service provider has market power, there are fewer substitutes of the product or insufficient information exists to enable the consumer to effectively negotiate with the network. By contrast, services that are classified as negotiated should display these characteristics less strongly. For example, the service provider might have less market power where services are classified as negotiated." (our underline)

We have taken this opportunity to consider aspects of the AEMC's statements, including "parties can negotiate the terms and conditions for services", "monopoly power" and "market power" aspects.

In consideration of the NEO, our view is only natural monopoly services (eg "poles and wires") provided by the DNSP should be classified as a Direct Controlled Services and then further classified as either "Standard" or "Alternative" for the purposes of establishing appropriate price controls.

To promote sector development, and consistent with the NEO, all other services where the DNSP does not have a clearly established natural monopoly should either be classified by the AER as Negotiated Distribution Services, or not classified. The AER in SA requires recognition and commendation as it has best embraced this concept. The SA NDS have been included in Attachment A.

Critically, the AER does not establish services – it only establishes prices. As such the AER must in its process identify a specific service, classify that service, and then determine a price for that service using the appropriate price control mechanism.

The AER price determination is not dynamic, and does not seek to confirm or establish consumer service requirements. Further, the AER has no price or service flexibility for Direct Controlled services. Its determination process is simply not designed to accommodate changing market conditions and service requirements during a regulatory period.

A price and service issue arises where the AER has classified a service (typically) as "Direct/Alternative" controlled service, and the consumer requires a different service to those considered by the AER to establish prices via a regulatory determination.

An example is public lighting in Victoria and Tasmania where the AER classified services for existing public light types as a Direct Controlled and then Alternative Controlled services. It however (and in our view appropriately) at least classified "new light types" as an NDS. For example, the Victorian 2011-16 Determination for Jemena included the following NDS:

"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 green field sites)¹

The issue becomes where a customer requires upgrading existing light types to the new light types. Whilst consumers can negotiate service and price with the DNSP for the new light types (as an NDS), it has no "market power"² to require the DNSP to alter its existing Alternative controlled tariffs and services or to establish alternative prices and services for existing light types (Alternative controlled) to recognise the DNSP's changed costs and the consumers changed service requirements.

This is where issues pertaining to cost allocation in the CAM are encountered by consumers. Are the DNSP's costs being appropriately allocated? Is the distributor (inadvertently) allocating overheads or other costs more than once? Without any cost allocators it is impossible for consumers to effectively assess. The AEMC correctly points out consumers can request information from distributors to establish NDS prices. There is however no such facility to request information regarding other service classifications.

Current federal government funding programs will see \$10's of millions of public funds allocated to new light types over the coming years, so the issue may be considered material by the AEMC.

In section 4.1 of its DD the AEMC claimed:

"The rule change request seeks to impose greater regulatory control over services that have been classified as negotiated. For example, it seeks to have numeric allocators for services included in the cost allocation method to provide negotiating parties with greater understanding of the underlying costs.

In fact, the nature of the negotiated service should mean that those negotiating with service providers have adequate negotiating power already. "

We trust by providing the public lighting example above we have established we were not seeking greater regulatory control, but rather increased flexibility to establish both services and prices consistent with the NEO with the DNSP ,and to do so, we are seeking:

- greater transparency in DNSP costs, including numeric cost allocation in the CAM, and
- a clear methodology and basis for costs via the Rule change to NER 6.7.1 (1)

3. NER 6.7.1 (1) - "Must"

We proposed a Rule change to NER 6.7.1 (1) providing that "the price for a *negotiated distribution service* must be based on the costs incurred....."

The AEMC has correctly identified NER 6.7.1 (1) represents a negotiated service criteria pricing principle, and the negotiated service criteria are determined as part of the AER's revenue determination.

We advise the AEMC our inclusion of "significant imbalance of market power" in consideration of this proposed Rule change is misplaced. Our view however remains it is appropriate that a price charged by the DNSP must be based on the cost incurred in providing that service.

The AER in its initial submission to the Rule change Request stated "*Either way, prices are only based on costs.*". It then follows that prices must be based on a distributor's costs.

In considering the AEMC's view that "should" provides the AER some "degree of discretion", we submit the AER is already provided a degree of discretion in the pricing principle as the price must be "based on" the DNSP's cost.

¹ Page 8, Jemena Electricity Networks (Victoria) Ltd, Distribution determination 2011–2015, Pursuant to Orders of the Australian Competition Tribunal in *Application by United Energy Distribution Pty Limited (No 2)* [2012] ACompT 8, September 2012

² This was the "market power" we identified in our Rule change request.

We note the AEMC's views on transparency, engagement and Regulatory process. and submit by including "must" in the principle it simply, but importantly:

- Establishes a clear "starting point" for establishing DNSP prices, because as the AER pointed out "*prices are only based on costs.*"
- Removes the continued requirement for consumers to "influence the AER's decision making" as part of each determination process, and
- Still retains a "degree of discretion" for the AER as prices must be "based on" the DNSP's cost.

The AEMC has raised an issue regarding the potential for this proposed change to detract from the clarity of the Rules. This aspect could be more problematic but could potentially be mitigated by changing other principles on a similar basis ie "must". If this cannot easily be done then consumers will need to continue to influence the AER's decision making as part of each determination process.

Further Information

We would welcome the opportunity to provide further clarification on any aspect of this submission.

Yours sincerely,

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Attachment A³

Schedule 1. Classification of Negotiated Distribution Services

The categorisations of *Negotiated Distribution Services* in this table correspond to those defined in more detail in Attachment B.2 of ETSA Utilities Regulatory Proposal.

Negotiated Distribution Service <small>'B.x' references refer to categorisations defined in Attachment B.2 of ETSA Utilities Regulatory Proposal</small>	Classification of Service ⁸	
	<i>Individually Negotiated Service</i>	<i>Indicative Price List Service</i>
B.7 Non-standard network services	All	
B.8 Non-standard connection services	Non-repetitive	Repetitive
B.9 New and upgraded connection point services	Non-repetitive	Repetitive
B.10 Non-standard small customer metering services		All
B.11 Large customer metering services		All
B.12 Public lighting services	Non-repetitive	Repetitive
B.13 Stand-by and temporary supply services	Non-repetitive	Repetitive
B.14 Asset relocation, temporary disconnection and temporary line insulation services	Non-repetitive	Repetitive
B.15 Embedded generation services	All	
B.16 Other services		
(a) services in connection to ETSA Utilities' Distribution licence obligations or the NER;	Non-repetitive	Repetitive
(b) provision of reactive power and energy to a connection point or receipt of reactive power and energy from a distribution connection point;		All
(c) investigation and testing services;	Non-repetitive	Repetitive
(d) asset location and identification services;	Non-repetitive	Repetitive
(e) the transportation of electricity not consumed in the distribution system;	All	
(f) the transportation of electricity to distribution network users connected to the distribution system adjacent to the transmission system;	All	
(g) repair of equipment damaged by a distribution network user or a third party;	All	
(h) provision of high load escorts;	Non-repetitive	Repetitive
(i) provision of protection systems;	All	

⁸ Shading indicates applicability of either the *Individually Negotiated Service* or *Price List Service* frameworks. Both frameworks apply to many services owing to the high variability of the scope and complexity of services within each category.

³ ETSA Negotiation Framework

Negotiated Distribution Service <i>'B.x'</i> references refer to categorisations defined in Attachment B.2 of ETSA Utilities Regulatory Proposal	Classification of Service ⁸	
	Individually Negotiated Service	Indicative Price List Service
(j) Provision of pole or structure attachments, ducts or conduits;	Non-repetitive	Repetitive
(k) Additional costs arising from customer non-compliance with obligations;	Non-repetitive	Repetitive
(l) Customer default resulting in work not being able to be undertaken or completed as planned;	Non-repetitive	Repetitive
(m) TV or radio interference investigation where <i>ETSA Utilities'</i> network is not the cause;	Non-repetitive	Repetitive
(o) Investigation of supply interruption not due to <i>ETSA Utilities'</i> network; and	All	
(p) Provision of information not related to connection enquiries.	Non-repetitive	Repetitive