14 March 2013

Ms Tara D'Souza
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Australian Energy Market Commission
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Email: submissions@aemc.gov.au

Dear Ms D'Souza

CONSULTATION PAPER – NATIONAL ELECTRICITY AMENDMENT (CHANGES TO COST ALLOCATION METHOD) RULE 2013

SA Power Networks is pleased to respond to the Australian Energy Market Commission's (AEMC) consultation paper in relation to the rule change request from Trans Tasman Energy Group (the proponent) to amend Chapter 6 of the National Electricity Rules (NER) in relation to the Cost Allocation Method and also the principles relating to access to negotiated distribution services.

SA Power Networks recognises its responsibilities in regards to the negotiation distribution principles as set out in clause 6.7.1 of the NER. It strives to negotiate in good faith and to provide all of the information reasonably required to achieve effective negotiation. SA Power Networks is of the view however that the rule changes proposed by the proponent will not further promote the National Electricity Objective (NEO) as set out under section 7 of the National Electricity Law (NEL), for the following reasons:

- The changes will increase regulatory burden on Distribution Network Service Providers (DNSPs);
- The costs to implement and comply with these changes will significantly outweigh the benefits;
- The changes will not improve transparency in relation to the Cost Allocation Method; and
- They will not lead to more efficient prices for network services.

The salient views of SA Power Networks in regard to the proposed rule change are listed below:

- By definition, negotiated distribution services are subject to more light handed regulation than direct control services and include a dispute mechanism as specified in the Negotiated Distribution Service Criteria. The existing principles and framework relating to access to negotiated distribution services are comprehensive, and include the requirement for the DNSP to provide an access seeker with all of the relevant commercial information that they reasonably require to negotiate effectively (NER 6.7.5 (c)(2)).

- The proponent has claimed that there is a failing in the current arrangements, but has not clearly this failing nor its impact. Further, the proponent has not explained how the proposed changes would remedy any such failing. There is no clear evidence that the proposed changes would lead to more efficient prices for network services.
- The proponent has expressed the view that a DNSP's Cost Allocation Method "should be open to review so customers can assess the appropriateness of the distributor's CAM"[1] in connection with negotiations of negotiated distribution services. Rather, as the Cost Allocation Method has application across all service classifications, it is the view of SA Power Networks that the responsibility for assessing the appropriateness of, and approving, a DNSP's Cost Allocation Method, is better exercised by the AER, having regard to the long term interests of all customers in the context of the broader regulatory framework.
- Cost allocation methodologies drive DNSPs' accounting practices, and there are obvious economic reasons for favouring long term consistency, as changes will affect statutory, management and regulatory accounting. Statutory and regulatory accounts are prepared in accordance with the frameworks and requirements set by the relevant governing bodies. It is the view of SA Power Networks that the existing governance arrangements, as they pertain to the setting of accounting policies, are sufficient, and thus it is neither realistic nor appropriate for customers to be consulted in respect of a DNSP's accounting policies. To this end, the proposed rule changes appear to be intrusive and inappropriate.
- Cost Allocation Methods have already been established by each of the DNSPs and approved by the AER, and it is unlikely that further comprehensive changes will be made, other than in response to a change to the Cost Allocation Guidelines, which would be subject to the distribution consultation procedures. SA Power Networks therefore questions whether there is any material likelihood that meaningful consultation would be captured by the proposed rule change that would not be captured by the existing arrangements. In this, much relies on the meaning of "amendment" to Cost Allocation Methods, which would need to be clearly defined.
- Costs allocated to a particular service cannot be reallocated during the course of a regulatory control period under existing Cost Allocation Principles (NER 6.15.2 (7)), therefore material changes to the Cost Allocation Method can only be applied as a part of the regulatory reset process, and consultation would need to be finalised before submission of the regulatory proposal.
- The inclusion of numeric values in the Cost Allocation Method is considered to be unlikely to assist stakeholders in isolation. In particular, it would not further assist a customer's understanding of costs pertaining to a particular service.
- The publication of the numeric values of allocators may also identify commercially sensitive information applying to unregulated business activities of the DNSP, potentially putting that part of an organisation at a competitive disadvantage. Any adverse impacts on the unregulated business may well flow to regulated customers by impacting the allocation drivers that apply across service classifications (e.g. a reduction in unregulated revenue may result in additional costs being allocated to direct control and negotiated services).

[1] Trans Tasman Energy Group Rule Change Request, Section 3

- SA Power Networks is of the view that the cost of the rule changes will far outweigh the benefits, having regard to:
    - AER resources and time in an already crowded process, as it will require another layer of consultation; and
    - DNSP resources through updating the Cost Allocation Method annually with numeric values, and managing, and more importantly educating, interested third parties.
- We note that a major concern of the proponent appears to relate to verifying compliance with the approved Cost Allocation Method, yet a Regulatory Information Notice (RIN) template is devoted to this and independent auditors confirm that costs have been allocated in accordance with the approved Cost Allocation Method.
- Imposing a pricing requirement for negotiated distribution services based on cost as proposed by the proponent will effectively limit the negotiation process. A high degree of price setting direction would require the Cost Allocation Guidelines to be very prescriptive in all aspects of costs, which is neither practical nor desirable for negotiated prices, and is also likely to reduce the AER's flexibility in the interpretation or application of the negotiated distribution services framework.

Responses to specific questions raised in the consultation paper are contained in the following pages.

Yours sincerely

Sean Kelly
General Manager Corporate Services

SA Power Networks
Response to Consultation Paper – Changes to Cost Allocation Method

Question 1

Is the assessment framework presented in this consultation paper appropriate for assessing this rule change request?

SA Power Networks has no concerns with the assessment framework.

Question 2

How often is the cost allocation method likely to change? What are the costs for stakeholders, including the AER, of public consultation for a change in the cost allocation method?

- SA Power Networks believes that its Cost Allocation Method is unlikely to change very often, other than in response to a change to the Cost Allocation Guidelines. However if there is a new requirement to update annually to include numeric values, additional cost will be incurred by DNSPs.
- SA Power Networks questions whether there will there be a requirement for consultation for annual revisions of numeric values, and how a "reasonable" level of third party inquiry will be determined and potentially arbitrated. If there is to be consultation on annual revisions, the additional costs to DNSPs could be significant.
- Whether or not there will be consultation, the value of any rule change must be clearly demonstrated. Compliance with the Cost Allocation Method is already considered as part of the independent audit, for which DNSPs are already incurring significant cost. Furthermore, the additional disclosure of certain business costs in isolation will be of very limited benefit for the negotiation of prices.
- Costs (and time constraints) to the AER are likely to be significant if it is required to consider and evaluate interested party responses. It is assumed that the process would involve an issues paper, draft decision and final decision (in line with the current process), in addition to consultation with stakeholders.

Question 3

What information is included in the cost allocation method in practice? How does this differ between DNSPs? Is comparability of cost allocation methods between DNSPs relevant to the negotiation framework? What is the cost of providing more detailed information of allocators?

- Please refer to question 2 responses above.
- SA Power Networks' Cost Allocation Method contains the principles and policies for attributing costs to, or allocating costs within, the categories of distribution services that are provided to customers, in accordance with the AER's Cost Allocation Guidelines. It contains the methodology and drivers for allocating costs between standard control, alternative control, negotiated distribution and unregulated services. The quantum of allocated costs is calculated as part of the annual budget process.

- SA Power Networks' Cost Allocation Method drives it's statutory, management and regulatory accounting. We are of the view that accounting policy is set in accordance with the frameworks and requirements set by the relevant governing bodies, and it is neither realistic nor appropriate for customers to consult on this process. A business should clearly have the ability to choose its approach to cost allocation within regulatory boundaries.
- The question of comparability of Cost Allocation Methods is being addressed in consideration of the AER's "Expenditure forecast assessment guidelines for electricity distribution and transmission - issues paper" (issued December 2012). SA Power Networks endorses the view of the Energy Networks Association that interfering with cost allocation policies is not a proportionate regulatory response to perceived problems in comparability of DNSP's Cost Allocation Methods.
- There is a disparity in the classification of particular "like" services between jurisdictions. Similar services can be classified as negotiated distribution services in one jurisdiction and as alternative control services, or even standard control services, in another. Some jurisdictions have few negotiated distribution services, but this proposal would affect all DNSPs equally. The costs of this proposal therefore need to be carefully assessed against the expected benefits, having regard to a detailed assessment of which specific negotiated distribution services would be impacted (i.e. which services are capable of experiencing any material benefit).

Question 4

Are the problems that the proponent identified also present in the transmission frameworks for cost allocation method and negotiated services?

- SA Power Networks has no comment in response to this question.

Question 5

Is additional consultation required? Are the Distribution Consultation Procedures an appropriate framework for consultation in this context? Will the AER have sufficient time to adequately consider stakeholder views with the consultation procedures? Will consultation delay changes to a cost allocation method?

- SA Power Networks is of the view that consultation on the Cost Allocation Method as proposed is not warranted and that the additional cost and effort required for consultation of the Cost Allocation Method would far outweigh any benefits that can be established in what is already a complex process (for DNSPs and the AER). This is relevant in terms of:
    - AER resources and time, as it will require another layer of consultation; and
    - DNSP resources through updating and reissuing the CAM annually with numeric values, and managing and more importantly educating interested third parties.
- Cost Allocation Methods have been established by each of the DNSPs and approved by the AER, and it is unlikely that further comprehensive changes will be made, other than in response to a change to the Cost Allocation Guidelines. SA Power Networks questions whether the proposed consultation with stakeholders will just apply to changes, or whether it will be an opportunity for a customer to challenge all allocations? Consultation on minor changes would be of limited value, but forced widespread changes will add considerable cost and burden to DNSPs.

- Any consultation will add to the time and cost in establishing or changing a Cost Allocation Method. The degree of this will be dependent on the consultation process. This could be considerable and lead to significant cost and delays. Any changes to the Cost Allocation Method will impact all customers, including other network customers, so their views must also be considered in the consultation process.

Question 6

Will the inclusion of numeric quantities require more frequent updating of cost allocation methods? Does the proposed solution to include numeric quantities achieve the aim of including sufficient information to replicate costs to be recovered?

- Inclusion of numeric quantities will require updating at the least on an annual basis, assuming that values are calculated as part of an annual budget process.
- SA Power Networks believes that the inclusion of numeric values is intrusive and is meaningless in isolation. Costs will undoubtedly vary between DNSPs and will be driven by many factors. Consequently, inclusion of numeric values would not further assist a customer's understanding of costs pertaining to a particular service.
- SA Power Networks also has a major concern that the inclusion of numeric values may identify commercially sensitive information applying to unregulated business activities, potentially putting that part of the organisation at a competitive disadvantage. Any adverse impacts on the unregulated business may well flow to regulated customers by impacting the allocation drivers that apply across service classifications (e.g. a reduction in unregulated revenue may result in additional costs being allocated to direct control and negotiated services).

Question 7

To what extent do the existing principles influence the negotiation criteria? Is imposing a pricing requirement consistent with the level of regulation appropriate for negotiated services?

- By definition, negotiated distribution services are subject to more light handed regulation than direct control services and include a dispute mechanism as specified in the Negotiated Distribution Service Criteria. SA Power Networks believes that the principles and framework relating to access to negotiated distribution services are already comprehensive, and include the requirement for the DNSP to provide an access seeker with all of the relevant commercial information that they reasonably require to negotiate effectively (NER 6.7.5 (c)(2)), and that the request for further information will not lead to more efficient prices for network services.
- A major concern of the proponent appears to relate to verifying compliance with the Cost Allocation Method. It is a requirement under NER 6.15 that the DNSP must comply with the approved Cost Allocation Method (6.15.1) and must not allocate costs more than once (6.15.2 (5)). A RIN template is devoted to this and independent auditors confirm that costs have been allocated in accordance with the approved Cost Allocation Method. This should provide sufficient comfort to customers that a DNSP has met its obligations. SA Power Networks does not believe that the value of allocators will provide any assistance in verifying compliance with the approved Cost Allocation Method.

- Imposing a pricing requirement for negotiated services based on cost as proposed by the proponent will effectively limit the negotiation process. The existing principles relating to negotiated distribution services are quite clear in regard to price determination, no further amendment is deemed necessary.
- A high degree of price setting direction would require the Cost Allocation Guidelines to be very prescriptive in all aspects of costs. SA Power Networks do not believe that this is either practical or desirable for negotiated prices and is likely to reduce the AER's flexibility in the interpretation or application of the negotiated distribution services framework.

Question 8

If the cost allocation principles are amended are the existing arrangements sufficient to enable compliance? Should transitional arrangements be considered to allow any rule changes to have effect as soon as possible?

- Any changes to the Cost Allocation Method will impact other allocations to other service classifications, including standard control and alternative control services. It would only be practical to apply the rule change as a part of the regulatory reset process and consultation would need to be finalised before submission of the regulatory proposal.
- Costs allocated to a particular service cannot be reallocated to another during the course of a regulatory control period under existing Cost Allocation Principles (NER 6.15.2 (7)). Any changes during a regulatory period would be challenging and potentially inequitable.