

The Chairman
Australian Energy Market Commission
PO Box H166
AUSTRALIA SQUARE NSW 1215

RECEIVED
27 SEP 2006

25 September 2006

Dear Dr Tamblyn

Transmission Pricing for Prescribed Transmission Services: Rule Proposal Report

Integral Energy welcomes the opportunity to comment on the Review of Electricity Transmission Pricing Rules: Rule Proposal Report and Proposed National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 (Draft Rules), prepared by the Australian Energy Market Commission (AEMC).

Integral Energy supports the Draft Rules, however, considers the following issues need to be addressed to promote the efficiency and transparency of transmission pricing.

Aggregate Annual Revenue Requirement (AARR)

Pricing Principles

Integral Energy notes the principles-based approach adopted by the AEMC for transmission pricing, and the causer pays principle in providing price signals for economic decision making. Therefore, it is a concern that the AEMC has proposed the maintenance of a pricing methodology based on average cost only in realising a TNSP's *aggregate annual revenue requirement* (AARR).

Integral Energy recognises that the adoption of a cost allocative pricing methodology may be appropriate to ensure the recovery of transmission investments necessary to meet reliability obligations and multiple purposes, and the recovery of sunk costs. Where the "causer" of a transmission investment can be identified, the AEMC should consider methodologies which can deliver more efficient outcomes, such as marginal cost pricing.

Pricing based on marginal costs should be forward looking and in line with the transmission revenue determination. Accordingly, Integral Energy submits that the proposed Draft Rules be amended to include a provision for long run marginal cost pricing methodology reflective of the long life of transmission assets and the long term interests of consumers.

Common Transmission Services

Under proposed clause 6A.22.3(d)(2) of the Draft Rules, the *AARR* excludes operating and maintenance costs incurred in the provision of *common transmission services*.

Common transmission services are defined as:

“prescribed transmission services that ensure the integrity of a transmission system and provide equivalent benefits to all Transmission Customers who have a connection point with the relevant transmission network without any differentiation base on their location within the transmission system.”

As the AARR represents the *maximum allowed revenue* for a TNSP for the provision of *prescribed transmission services* provided by that TNSP for a *regulatory year* of a *regulatory period*, it is unclear to Integral Energy why the operating and maintenance costs incurred in the provision of *common transmission services* (which form a part of *prescribed transmission services*) are excluded from the AARR.

It is also unclear to Integral Energy how the AER can fulfil its obligations and the intent of section 16 of the *National Electricity Law* (NEL) without recognising the recovery of operating and maintenance costs incurred by TNSPs in providing *common transmission services*. Under section 16 of the NEL, the AER in making a transmission determination must provide a reasonable opportunity for the regulated transmission system operator to recover the efficient costs of complying with a regulatory obligation. The AER cannot provide that opportunity if it is prohibited from considering the efficient costs incurred in the provision of prescribed transmission services.

To do otherwise, would be to acknowledge that the proposed clause 6A.22.3(d)(2) of the Draft Rules is inconsistent with the NEL and therefore makes its validity open to question.

Pricing Methodology Guidelines

The Draft Determination states:

“The proposed Pricing Rule requires each TNSP to develop and submit a proposed pricing methodology to the AER that will apply during a regulatory control period. The AER is required to approve the proposed pricing methodology if it determines that it is consistent with the pricing principles and the Pricing Methodology Guidelines (as developed by the AER). It is only if the AER determines that the TNSP’s proposed methodology is not consistent with the principles and Guidelines that it is empowered to substitute a different or modified methodology¹.”

Clauses 6A.23 and 6A.25 of the Draft Rules is intended to give effect to this statement in the Draft Determination.

Integral Energy notes a fundamental principle underpinning the reform of the National Energy Market (NEM) by the Ministerial Council on Energy (MCE) was to ensure a separation of rule making from rule enforcement and economic regulation. Under the policy and legislative framework developed by the MCE, the AEMC was given specific Rule making powers while the AER was given powers to perform Rule enforcement and undertake certain economic regulatory functions.

It is not the intention of the MCE or the legislative amendments to the National Electricity Law (NEL) that the AER be given the power to make ‘Rules’ with respect to the economic regulation of transmission systems.

¹AEMC 2006, Proposed National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006, Rule proposal Report, 24 August 2006, Sydney, p16.

Section 35 of the NEL sets out the obligations of the AEMC to make Rules for or with respect to the matters or things specified in items 15 to 24 of Schedule 1 of the NEL (relating to transmission system revenue and pricing). Item 20 of Schedule 1 requires the AEMC to make Rules with respect to “*the mechanisms or methodologies for the derivation of the maximum allowable revenue or prices to be applied by the AER in making a transmission determination.*”

Under clause 6A.23, when the TNSP proposes the pricing methodology it must do so not only in accordance with the *Pricing Principles* stated in the Rules (to the satisfaction of the AER), but also in accordance with the *Pricing Methodology Guidelines* developed by the AER. Otherwise the AER will substitute its own methodology to the TNSP.

Consistent with the requirements of section 35 of the NEL, Integral Energy submits that clause 6A.25 of the Draft Rules be amended to clarify that the *Pricing Methodology Guidelines* developed by the AER should not have the effect of limiting the type of pricing methodologies which may be proposed by a TNSP.

Further, as presently drafted, clause 6A.23(a) provides a discretion to the AER not to approve a proposed pricing methodology as part of the transmission determination, even where the pricing methodology gives effect and is consistent with the *Pricing Principles* and the *Pricing Methodology Guidelines*. This discretion appears at odds with both the Draft Determination and the intent of NEL. Accordingly, Integral Energy submits that clause 6A.23(a) be amended to read:

“In making a *transmission determination* under Part E of Chapter 6A, the AER must approve a proposed *pricing methodology* that is consistent with the *Pricing Principles* and the *Pricing Methodology Guidelines*, as part of that *transmission determination*.”

Common transmission services

Integral Energy notes that the proposed definition of “common transmission services” omits reference to the integrity of the distribution system and the benefits to distribution customers. It is a matter of concern that their omission from the proposed definition is not discussed in the Draft Determination and no reason has been proffered justifying its exclusion from the proposed new definition of “common transmission services”.

The inclusion of references to the integrity of the distribution system and the benefits to distribution in the existing definition of “common services” in the Rules recognises the interdependence of the transmission and distribution systems. For example, where a TNSP is operating above secure transformer levels at a given transmission location, the distributor may switch load away to other bulk supply points to relieve pressure off the transmission system at the expense of placing the distribution system under greater pressure.

Accordingly, Integral Energy submits that the proposed definition of “common transmission services” include references to the integrity of the distribution system and the benefits to distribution.

Publication of pricing methodology and transmission network prices

Proposed clause 6A.26.14 of the Draft Rules requires a TNSP to publish the prices of each of the categories of prescribed transmission services to apply for the following financial year by 15 May each year.

The 15 May publication date poses significant problems for NSW distribution businesses, which are required to submit their network pricing proposals for the forthcoming year to IPART on the first Monday of April of each year. To meet this timeframe, NSW distribution businesses rely on estimates of transmission prices in March for incorporation in their network pricing proposals.

A publication date of 15 March of each year will ensure that distribution businesses have sufficient time to prepare their network pricing proposals and eliminate unnecessary TUOS price volatility, which has the potential to create uncertainty and to distort the network price signals for large customers.

Prudent Discount

Integral Energy supports the elevation of the AER's existing negotiation guidelines into the Rules, including the 'safe harbour' provision in Guideline 3 whereby 70% of a discount can be recovered from other transmission customers without having to demonstrate that the discount is the minimum necessary to avoid inefficient by-pass and must not result in any other transmission customer being made worse off compared to the situation if no discount were given. Integral Energy considers this arrangement benefits from transparency, certainty and correcting distortions in the price signal. For example, where a large customer has a lower cost network by-pass option compared to transmission charges (based on average cost pricing), it would be inefficient to adopt the network by-pass option if prices were based on the marginal cost of using the network.

Integral Energy notes that other transmission customers also benefits through the common service component of their transmission charges in ensuring large customers do not by-pass the transmission network and continue to contribute (albeit a lower level) to common cost recovery.

Proposed clause 6A.27.2(d) of the Draft Rules, provides the AER with the discretion to approve the proposed recovery amount if clause 6A.27.1(e) (specifying the requirements for recovering more than 70% of the discount amount) is satisfied.

Integral Energy submits that if the AER considers the requirements of clause 6A.27.1(e) are satisfied and the TNSP has provided the AER with information it requires for the making of a determination in accordance with clause 6A.27.1(g), there is no reason for the AER to have a further discretion to reject the recovery of the proposed recovery amount by the TNSP.

Accordingly, Integral Energy submits that the word "may" in clause 6A.27.1(d) be amended to read "must", so that where the AER considers the requirements of clause 6A.27.1(e) have been satisfied and the TNSP has provided the information required by the AER with the information it requires under clause 6A.27.1(g), the AER must approve the recovery of proposed recovery amount.

Should you wish to discuss the issues raised in this letter, would you please contact Erik Beerden, telephone number (02) 9853 6904.

Yours faithfully



Richard Powis
Chief Executive Officer