AEMC

Australian Energy Market Commission

Draft Rule Determination

National Electricity Amendment (Transmission Network Prices Publication Date) Rule 2008

Rule Proponent(s)
EnergyAustralia

20 November 2008

Signed: ....

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For and on behalf of
Australian Energy Market Commission

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About the AEMC

The Council of Australian Governments, through its Ministerial Council on Energy, established the Australian Energy Market Commission (AEMC) in July 2005 to be the Rule maker for national energy markets. The AEMC is currently responsible for Rules and policy advice covering the National Electricity Market. It is a statutory authority. Our key responsibilities are to consider Rule change proposals, conduct energy market reviews and provide policy advice to the Ministerial Council as requested, or on AEMC initiative.

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Abbreviations

AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
Commission	see AEMC
DNSP	Distribution Network Service Provider
MAR	Maximum Allowed Revenue
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEM	National Electricity Market
Rules	National Electricity Rules
TNSP	Transmission Network Service Provider
TUoS	Transmission User of Service

Summary

On 27 June 2008 the Commission received a Rule Change proposal from EnergyAustralia that proposed to move the publication date for categories of prescribed transmission services from the 15 May to the 15 March each year.

The main arguments proposed by EnergyAustralia in support of the proposed Rule were that it would reduce the administrative burden associated with the price approval process; would induce more efficient and accurate pricing signals for customers; and enable DNSPs to avoid financial exposure. However, submissions challenged these claims.

The Commission assessed the Rule Change proposal and is of the view that the proposed Rule does not meet the statutory Rule making test. The Commission decided this on the basis that the proposed Rule would not be a proportionate response to the problem identified and thus would be inconsistent with good regulatory practice. The Commission also found that on the information available to it, the problem identified was not material and was specific to New South Wales.

Specifically, the Commission found that if the proposed Rule was adopted, consequential changes would need to be made to the Rules as well as in practices and procedures which would create additional burdens on other participants. It was therefore doubtful whether the proposed Rule would reduce administrative burdens overall and, unless these consequential issues were resolved, the proposed Rule may perpetuate uncertainty in calculating transmission prices. The proposed Rule would also disadvantage Victorian TNSPs which do not have access to over/under recovery mechanisms. Additionally, it is unclear whether an earlier publication date for transmission prices materially improves the consumer price signal.

The Commission also understands that EnergyAustralia and Transgrid have entered into arrangements under which they have agreed for an earlier publication date for transmission prices. This is a more appropriate solution and the problem identified by the Rule change proposal has been resolved.

Submissions on this draft Rule determination are invited. Submissions must be received by 23 January 2009. In accordance with section 101 of the NEL any interested person or body may request that the Commission hold a hearing in relation to the draft Rule determination. Any request must be received by the Commission no later than 28 November 2008.

Send submissions or requests for a hearing electronically to

submissions@aemc.gov.au
Or mail to:
Australian energy Market Commission
PO Box H166
AUSTRALIA SQUARE NSW 1215

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1 EnergyAustralia's Rule Change Proposal

1.1 Proposal

On 27 June 2008 the Commission received a Rule Change proposal from EnergyAustralia.[1] It proposed that the date of annual publication by Transmission Network Service Providers (TNSPs) of their prices for *categories of prescribed transmission services* (referred to as 'transmission prices') be moved from the 15 May to the 15 March each year (Rule Change Proposal).[2]

EnergyAustralia stated that the purpose of the proposed Rule Change proposal is to permit transmission prices to be properly incorporated into distribution prices to apply in the following financial year and significantly streamline the price approval process for both the regulator and Distribution Network Service Providers (DNSPs).[3]

EnergyAustralia requested that the Rule change be expedited under section 96 of the National Electricity Law (NEL) because, in its view, the request was for a non-controversial Rule.[4]

1.2 Problem to be addressed by the Rule Change

EnergyAustralia claims that DNSPs bear a risk forecasting transmission prices. Accordingly, the proposed Rule Change seeks to address the issue that DNSPs may, at times, be unable to effectively incorporate transmission prices into their distribution pricing and approval process. In its view, this is because the date for publication of transmission prices is too late. DNSPs rely on estimates of transmission prices which may materially differ from actual transmission prices. This leads to DNSPs bearing forecasting risk with consequences for their revenue recovery.[5]

The National Electricity Rules (Rules) provide that transmission prices must be published by the 15 of May each year for the purposes of determining *distribution service prices*.[6] However, under the Rules, in the first year of a five year *regulatory control period*, DNSPs must submit their *initial pricing proposal* to the Australian Energy Regulator (AER) within 15 *business days* after the publication of a distribution determination.[7] The Rules also provide that the AER must publish a distribution determination no later than two months before the commencement of a *regulatory*

[1] EnergyAustralia, *Rule Change Proposal: Variation of Date of Publication of Transmission Network Prices*, 27 June 2008 (Rule Change Proposal)

[2] Terms in italics have the same meaning as they have in the Rules.

[3] Rule Change Proposal, p 1

[4] Rule Change Proposal, p 5

[5] Rule Change Proposal, p 2-3

[6] Clause 6A.24.2 of the Rules

[7] Clause 6.18.2(a) of the Rules

control period.[8] Accordingly, if the AER published a distribution determination by 1 May at the latest, then the *initial pricing proposal* would need to be published by 15 May. For subsequent years within a *regulatory control period* (non-regulatory reset years), DNSPs must submit their annual *pricing proposal* to the AER at least two months before the commencement of the upcoming regulatory year.[9] The situation arises that for non-regulatory reset years the submission of annual distribution pricing proposals falls before the publication of transmission prices. For distribution pricing proposals due in a regulatory reset year, transmission prices are only received marginally before, or at the same time, as when distribution pricing proposals are due.

According to EnergyAustralia, DNSPs must rely on estimates based primarily on transmission prices from previous years. If DNSPs find that a TNSP's published prices are materially different from earlier estimates, then DNSPs may either:

- accept that a material over or under recovery of transmission use of system charges (TUoS) will occur the following financial year; or

- request the regulator to allow them to resubmit their prices. However, there is only a short timeframe for DNSPs to recalculate their prices and for the AER to approve it.[10]

1.3 Proponent's proposed solution

EnergyAustralia's proposed solution is that TNSPs be required to publish transmission prices two months earlier; that is, 15 March rather than 15 May of each year.

EnergyAustralia argued that the proposed Rule would give DNSPs sufficient time to receive finalised transmission prices so that these prices could be incorporated into their distribution pricing proposals.[11] This would eliminate any forecasting risk on the part of DNSPs because they would receive actual transmission prices.

Energy Australia also argued that customers, particularly large customers, would benefit from having up-to-date transmission price signals because it would reduce price variability.[12]

1.4 Consultation

On 24 July 2008, the Commission published a notice under section 95 of the National stating that it proposed to expedite and commence the Rule change process under

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[8] Clause 6.11.2(2) of the Rules

[9] Clause 6.18.2(a)(2) of the Rules

[10] Rule Change Proposal, p 3

[11] Rule Change Proposal, p 4

[12] Rule Change Proposal, p 4

section 96 of the NEL, subject to the receipt of written objections. Interested parties had until the 8 August 2008 to submit written objections.

On 8 August 2008, a written objection from Grid Australia was received. Grid Australia's view was that this Rule Change raised issues sufficiently complex for it not to be treated as a non-controversial Rule.

Grid Australia raised the following concerns with respect to an earlier transmission prices publication date:

- greater inaccuracy of forecast transmission pricing estimates as a result of two months less actual data;
- less certainty in the calculation of current year and forecast inter-regional settlement residues;
- less certainty in the calculation of current year revenue recovery for TNSPs; and
- additional price volatility which will impact upon TNSP's 'unders and overs' account leading to a distortion in the accuracy of TUoS prices.

Further, Grid Australia raised a number of issues pertaining to the practical implementation of this Rule Change Proposal. The Commission found that the written objection was not misconceived or lacking in substance. Accordingly, the Rule Change Proposal has been considered under the ordinary statutory rule making process.

On 22 August 2008, first round consultation closed and a total of six submissions were received. Four of those submissions (Integral Energy, Country Energy, Energex and EnergyAustralia) supported the Rule change proposal arguing it would streamline the pricing approval process and apportion a better balancing of forecasting risk. Two of the submissions (Grid Australia, VENCorp) were critical of the Rule change proposal for reasons similar to the written objection from Grid Australia noted above.

On 16 October 2008, the Commission published a notice under section 107 of the NEL to extend the publication of the draft Rule determination to 20 November 2008. The Commission considered that it was necessary to extend the period of publication on the basis of new information arising through consultation.

1.5 Consultation on draft Rule determination

The Commission invites submissions on this draft Rule determination by 23 January 2009.

In accordance with section 101 of the NEL, any interested person or body may request that the Commission hold a hearing in relation to the draft Rule determination. Any request for a pre-determination hearing must be made in writing and must be received by the Commission no later than 28 November 2008.

Submissions and requests for a hearing may be sent electronically to submissions@aemc.gov.au or by mail to:

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1255

2 Draft Rule Determination

2.1 Commission's draft Rule determination

In accordance with section 99 of the NEL, the Commission has made a draft Rule determination not to make the Rule proposed by EnergyAustralia.

2.2 Commission's considerations

This draft Rule determination sets out the Commission's reasons for not making the proposed Rule. In making this draft Rule determination, the Commission has taken into account:

- the Commission's powers under the NEL to make the Rule;
- the revenue and pricing principles set out in the NEL[13];
- the Rule Change Proposal and the proposed Rule;
- submissions received; and
- the Commission's analysis on the ways in which the proposed Rule will, or is likely to contribute to the NEO so that the statutory Rule making test is satisfied.

The Commission considers that the proposed Rule would not contribute to the NEO and is not consistent with the revenue and pricing principles. The Commission's reasons for not accepting the proposal to amend the transmission prices publication date in clause 6A.24.2 are that the proposed Rule, if made, would:

- be inefficient as it may require further Rule changes and amendments to practices and processes adopted by TNSPs and the AER. In the interim, it may create considerable uncertainty;
- be inequitable as some TNSPs may not have an opportunity to recover their efficient costs as they do not have an access to an under / over recovery price mechanism. This is inconsistent with one of the revenue and pricing principles (section 7A(2) of the NEL);
- not address the problem as it may be experienced by DNSPs in Victoria, whose prices are amended on a calendar year basis;
- be unlikely to address the consumer price signal issue raised by EnergyAustralia. Rather, as TNSPs would need to develop prices earlier on less accurate

[13] Under section 88B of the NEL the Commission is required to take into account the revenue and pricing principles set out in section 7A of the NEL with respect ot matters and things specified in items 15-24 and 25-26J of schedule 1 to the NEL.

information to meet an earlier publication date, they may need to rely further on an under / over recovery mechanism;

- be inconsistent with good regulatory practice and design as it would be a solution that is disproportionate to the extent and materiality of the problem raised (on the information provided to the Commission); and
- would be inefficient as arguably it is not required. DNSPs in other jurisdictions have managed this problem successfully another way. Further, the Commission understands that EnergyAustralia and TransGrid have negotiated a solution to the problem.

Therefore, the proposed Rule would not satisfy the Rule making test, taking into account the revenue and pricing principles because:

- it would be inconsistent with the principles of good regulatory practice and design;
- it may create uncertainty; and
- it would not provide for consistent treatment across the NEM of TNSPs and DNSPs.

2.3 Commission's power to make the Rule

The Commission is satisfied that the proposed Rule falls within the subject matters that the Commission may make Rules as set out in section 34 of the NEL and in Schedule 1 to the NEL. The proposed Rule is within:

- The matters set out in section 34 (1)(a)(iii), as it relates to the activities of persons participating in the NEM or involved in the operation of the national electricity system.
- The matters set out in items 15- 24 of Schedule 1 of the NEL as it relates to transmission system revenue and pricing.

3 Commission's assessment against NEL criteria

This Chapter sets out the Commission's assessment of the Rule Change Proposal and its reasons for not making the Rule proposed by EnergyAustralia.

3.1 Methodology

In assessing any proposed Rule change against the Rule making test, one must consider the counterfactual arrangements against which the Rule change is being compared in light of the NEO. In the present case, the relevant counterfactual would be a continuation of present arrangements under which EnergyAustralia would receive transmission prices annually on 15 May.

These arrangements have been assessed against the main arguments put forward by EnergyAustralia in support of the proposed Rule change being:

- a reduced administrative burden associated with the price approval process;
- more efficient and accurate pricing signals for customers; and
- the avoidance of financial exposure.

3.2 Rule making test and the National Electricity Objective

The Rule making test states that 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.[14] The overarching objective of the NEL 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:

- price, quality, safety, reliability and security of supply of electricity; and
- the reliability, safety and security of the national electricity system.[15]

The NEO is founded on the concepts of economic efficiency (including productive, allocative and dynamic dimensions of efficiency), good regulatory practice (which refers to the means by which regulatory arrangements are designed and operated) as well as reliability, safety and security priorities.

3.3 Revenue and pricing principles

The revenue and pricing principles relate to providing a reasonable opportunity for regulated network service providers to recover at least the efficient costs, effective incentives to promote efficiency and to ensuring that prices should allow for a return

[14] See section 88(1) of the NEL

[15] Seee section 7 of the NEL

commensurate with the regulatory and commercial risks involved in providing the service.

As the matter raised by this Rule Change Proposal relate to the regulatory framework governing transmission revenue and pricing, the Commission must also take into account the revenue and pricing principles.

3.4 Reduced administrative burden

In its Rule Change Proposal, EnergyAustralia claimed that its proposed Rule would meet the NEO as it would significantly streamline the annual price approval process for the majority of distribution businesses and for the AER.[16] The proposed Rule would reduce the administrative burden experienced by distribution businesses and the AER of multiple revisions of distribution prices caused by reliance upon estimates of transmission prices.

By contrast, in its submission Grid Australia raised a number of issues that would need to be addressed if the Rule Change Proposal were to be accepted. These issues would create additional legal and administrative burdens and would need to be resolved for the proposed Rule to be applied. The issues include:

- For years prior to the commencement of a new regulatory control period, either the previous year's pricing methodology or a draft pricing methodology would need to be used because the AER's approval of final transmission pricing methodologies for that regulatory period would only occur by the end of April.[17] This would also require a Rule change.

- An earlier transmission prices publication date would require the use of less accurate CPI data; it would require either December quarter CPI data or substitute a forecast for the March CPI data.[18]

- It may be necessary for adjustments to the Maximum Allowed Revenue (MAR) (for example, adjustments to the MAR for service target performance incentive scheme) to be either accommodated in the year which it occurs or be carried over to adjustments made in subsequent year along with compensation for any foregone regulated returns due to the delay in revenue recovery.[19]

- The results of March quarter settlement residue auction proceeds would enable the required matching of settlement residue auction receipts with refunds to customers via the transmission pricing process. As VENCorp also notes, an earlier publication date would reduce accuracy of pricing forecasts that TNSPs use for TUoS prices as March quarter settlement residues would not be included.[20] Grid Australia stated that the earliest time that TNSPs could publish

[16] EnergyAustralia noted that the five Victorian distribution businesses set prices each calendar year.

[17] Grid Australia, Submission to First Round Consultation, p 7.

[18] Grid Australia, Submission to First Round Consultation, p 7.

[19] Grid Australia, Submission to First Round Consultation, p 8.

[20] VENCorp, Submission to First Round Consultation, p 3.

prices that make use of this information each year is early April and publication any time earlier would result in far less accuracy.[21]

- For an earlier transmission prices publication date, the coordinating TNSP for a given region must obtain information from its regional TNSPs at a much earlier time.[22]
- Information on energy consumption, maximum demand and network configuration would be less accurate if it had to be provided in line with an earlier publication date.[23]

VENCorp suggested that an earlier publication date would create unrealistic timeframes for TNSPs to calculate and approve TUoS prices.[24] This is particularly an issue for coordinating TNSPs who are dependent upon forecasts from the other TNSPs in their region. If an earlier publication date was mandated, then there would be significant variances between forecast and actual prescribed transmission service charges. If the Rule change is adopted then the Rules must be amended to include an obligation on parties providing information to coordinating TNSPs.

VENCorp also disagreed with EnergyAustralia's claim that transmission prices could be calculated based on CPI escalation from January quarter result, rather than the March quarter.[25] If CPI escalation was used, VENCorp could potentially breach its Network Service Agreement with its transmission service providers. Consequently, VENCorp would then need to amend its Network Service Agreements with other TNSPs, which incurs legal and administrative costs.

3.5 Price signals

EnergyAustralia stated that transmission prices published on 15 May cannot be satisfactorily factored into distribution prices. If the published transmission prices differ materially from estimates then the DNSP expect that a material over or under recovery will occur in the following year or it can request the regulator to allow the DNSP to resubmit its prices to the regulator (this can occur only in a short time frame).[26] Accordingly:

"[a] casualty of this sequence of events is the price signals which are passed on by the TNSP to the DNSP, which are intended to influence customers' consumption patterns. Even if the DNSP resubmits its prices, the cost allocation at specific

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21 Grid Australia, Submission to First Round Consultation, p 8-9.

22 Grid Australia, Submission to First Round Consultation, p 9.

23 Grid Australia, Submission to First Round Consultation, p 10.

24 VENCorp, Submission to First Round Consultation, p 2.

25 VENCorp, Submission to First Round Consultation, p 3.

26 EnergyAustralia Rule Change Proposal, p 3.

locations is, of necessity, simply scaled to match the required transmission revenue to be recovered."[27]

In EnergyAustralia's view, the proposed Rule would significantly improve signalling of transmission prices to customers by reducing price volatility.[28] EnergyAustralia claimed that improving communication of price signals would minimise the overall costs of supply and encourage efficient investment in both demand and supply sides. For large customers in particular, EnergyAustralia argued, it is highly desirable that distribution prices fully reflect transmission price signals.

This argument and the one outlined above were supported by the other two New South Wales distribution businesses, Country Energy and Integral Energy. Energex also supported the Rule Change Proposal for these reasons and on the basis that it was reflective of arrangements that exist between Energex and Powerlink. No submissions in support of the Rule Change Proposal were received by DNSPs located in jurisdictions other than New South Wales and Queensland.

Grid Australia[29] and VENCorp[30] argued that the proposed Rule would distort price signals. An earlier publication date may lead to greater transmission pricing uncertainty, which affects the 'overs' and 'unders' provision. Significant variations to the 'overs' and 'unders' provisions may distort the locational price signals because relatively more is recovered from the non-locational charges for a given year. This reduces the allocative efficiency of transmission pricing arrangements. Further, such variations in 'overs' and 'unders' provisions may lead to more volatile transmission pricing signals in subsequent years.

3.6 Avoided financial exposure

In its submission, EnergyAustralia provided additional rationale to that contained in the Rule Change Proposal. It stated that the primary driver of the Rule Change Proposal is how best to allocate the financial risk arising from forecasting transmission prices for customers in the next financial year:

> "Under the current Rules, EnergyAustralia largely bears this risk as a DNSP. If published transmission prices from TransGrid (on 15 May) are higher than EnergyAustralia's estimate used in calculating proposed distribution prices (on 1 May), EnergyAustralia is financially exposed and only recovers the difference 24 months after the initial prices are set. EnergyAustralia does not have the information to predict transmission prices for the next year and is forced to base prices on simple escalation of previous year prices in the absence of advice from the TNSP…"[31]

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[27] EnergyAustralia Rule Change Proposal, p 3.

[28] Price volatility arises from a reliance upon price over and under recovery mechanisms when prices are adjusted in the year following the forecast year.

[29] Grid Australia, Submission to First Round Consultation, p 4-5.

[30] VENCorp, Submission to First Round Consultation, p 1.

[31] EnergyAustralia, Submission to First Round Consultation, p 1

EnergyAustralia provided an example of the financial consequences of inaccurate estimations of transmission prices. If published transmission prices were 10% higher than EnergyAustralia's estimate then EnergyAustralia would be short in the amount of TUoS revenue it recovers from customers. A 10% differential would represent around $15 million in revenue. EnergyAustralia stated, however, that it will be able to recover this revenue shortfall through an unders and overs recovery mechanism although it will take almost 24 months to recover the shortfall[32].

While acknowledging that the proposed Rule change would result in less certainty for TNSPs, EnergyAustralia maintained that this was preferable to calculating forecast transmission charges with relatively no information.

In its submission, Grid Australia argued that some TNSPs (ie. Victorian TNSPs) do not have access to 'overs' and 'unders' revenue recovery mechanisms in the Rules, and therefore need to be able to calculate their cost allocation and revenue exactly with information only available by late April. Grid Australia concluded that an earlier publication date would leave some TNSPs potentially unable to recover their revenue.[33]

3.7 Commission's Assessment

The Commission has assessed the Rule Change Proposal and is of the view that the proposed Rule does not meet the statutory Rule making test.

Amending the date for the publication of transmission prices:

- may require further consequential Rule changes, as well as a number of amendments to procedures and practices which have been developed and adopted by the AER and market participants around the data inputs and timing requirements required for the development of transmission prices. While the proposed Rule would reduce the administrative burden faced by DNSPs and the regulator in setting distribution prices, it would create additional burdens on other participants. Unless and until these consequential matters are addressed there could be uncertainty around the data to be used to calculate transmission prices;

- would disadvantage the Victorian TNSPs, in particular, SP Ausnet which does not have access to over/under recovery mechanisms. This would be inconsistent with one of the revenue and pricing principles[34] Further it would not address the issues raised by EnergyAustralia for Victorian DNSPs (whose prices are amended on a calendar year basis). It would result in inconsistent treatment across the NEM; and

- may not avoid the consumer price signal issue. According to Grid Australia, TNSPs would need to rely on over / under recovery mechanisms if an earlier

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[32] EnergyAustralia, Submission to First Round Consultation, p 3.

[33] Grid Australia, Submission to First Round Consultation, p 2.

[34] Section 7A(2) of the NEL.

publication date was adopted. On this basis the price signal risk referred to by EnergyAustralia may not be removed by the proposed Rule; rather it would be moved. In any event, it is not clear the extent to which an earlier transmission price publication date materially affects price signals for the vast majority of consumers, for whom transmission prices constitute a comparatively small component of their overall energy bill.

Good regulatory practice and design require a proportionate response to any problems raised. A proportionate response should be linked to the extent and materiality of the problem. On the information available to the Commission, the problem identified by EnergyAustralia appears to be specific to New South Wales. In fact, submissions have indicated that other jurisdictions either do not face this problem or there are co-operative arrangements in place that enable DNSPs to have more accurate transmission price estimates which reduces the DNSP's risk.[35]

Further the Commission has not been provided with adequate information that demonstrates that the problem is material. As stated above EnergyAustralia is not actually financially exposed by the problem it has raised. It can recover any shortfall amounts as a result of inaccurate estimates of transmission prices; albeit at a later date. A solution, such as the one proposed by EnergyAustralia, that mandates a change across the NEM, for an issue which only affects DNSPs in one jurisdiction (and indeed may cause significant inconvenience and disturbance to other market participants whose existing arrangements are functioning well, without further changes to the Rules and existing practices and processes) is not a proportionate response to the regulatory problem raised, and therefore inconsistent with good regulatory practice. Such a solution would also be inefficient

The Commission understands that EnergyAustralia and Transgrid have entered into arrangements under which they have agreed for an earlier publication date for transmission prices. This appears to be a more appropriate solution to the problem as it does not require changes to the Rules that would inconvenience other market participants and the AER and it is appropriately tailored to the relevant jurisdiction. It is therefore unnecessary to consider the proposed Rule further on the basis that the extant problem has been resolved.

[35] Grid Australia, Submission to First Round Consultation, p 5. See also Energex, Submission to First Round Consultation, p 1.