

ELECTRICITY TRANSMISSION NETWORK owners

Proposed National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006

Submission in Response to AEMC Rule Proposal

25 September 2006



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1. INTRODUCTION

In August 2006, the AEMC (“the Commission”) published the Proposed National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 (“Proposed Pricing Rule”) and an accompanying explanatory Rule Proposal Report. The publication of the Proposed Pricing Rule follows the Commission’s consideration of stakeholder submissions made in response to its Transmission Pricing Issues Paper published in November 2005.

The Electricity Transmission Network Owners Forum (“ETNOF”)¹ welcomes the opportunity to comment on the Proposed Pricing Rule. This document sets out ETNOF’s comments, and is structured as follows:

- Section 2 provides a summary and overview of ETNOF’s response to the Proposed Pricing Rule.
- Section 3 sets out comments on the definitions of certain terms in the Rules, and provides some suggested drafting amendments to clarify those definitions.
- Section 4 sets out comments on the proposed pricing principles, and provides some suggested drafting amendments to clarify those principles consistent with the intentions expressed by the Commission in its Rule Proposal Report.
- Section 5 provides comments on the provisions of the Rules relating to pricing methodology guidelines.
- Section 6 sets out comments on the process and procedures for approval of a TNSP’s pricing methodology, and proposes some drafting amendments to facilitate the implementation of the approved pricing methodology.
- Section 7 sets out comments on other matters.

2. OVERVIEW OF ETNOF’S RESPONSE TO THE PROPOSED PRICING RULE

In its submission on the November 2005 Transmission Pricing Issues Paper, the key points made by ETNOF included the following:

- The present level of prescription in the Rules should be preserved as this aids certainty, clarity and consistency in the regulatory arrangements.
- ETNOF concurs with the Commission’s view that a proposal for change to the transmission pricing Rules should only proceed if there is clear evidence that it will deliver a material net benefit.
- While the current pricing arrangements coupled with the related design features of the NEM may be less than theoretically perfect, they do provide a reasonable and practicable means of delivering appropriate economic signals to transmission network users.
- There is no evidence of which ETNOF is aware that would support the view that the transmission pricing arrangements have led to materially inefficient consumption or investment decisions in the NEM. Improvements could be made at the margin, but these

¹ ETNOF members are: ElectraNet Pty Limited, Powerlink Queensland, SP AusNet, Transend Networks and TransGrid.

improvements will not require fundamental reform or substantial changes to the present Rules.

ETNOF is pleased to note that these views appear to have been largely accepted by the Commission. In particular, we note that page 10 of the Rule Proposal Report states:

“The Commission has reached the view that the current approach to recovering the costs of the provision of Prescribed Transmission Services is broadly appropriate. Therefore, at this stage, the Commission does not consider that there is a need to alter the substance of the current approach to pricing for Prescribed Transmission Services. However, this view is conditional on the outcomes of the other reviews currently being undertaken.”

In addition we note that although the Commission considers the current transmission pricing Rules incorporate an unnecessary level of detail, the Rule Proposal Report also states that the proposed shift to a principles-based regulatory framework “confirms the continuation of current pricing practices while providing scope for pricing innovations to be proposed in accordance with principles in the Rules”². ETNOF welcomes the Commission’s confirmation of its intention that the Proposed Pricing Rules will accommodate the continuation of existing practices.

In addition, ETNOF strongly supports the Commission’s proposals (set out in clause 6A.27) to:

- elevate the present AER guidelines on prudent discounting to the Rules;
- include new provisions that allow (but do not oblige) a TNSP to seek ‘up-front’ approval of a discount from the AER and for such an approval to remain effective for the duration of the TNSP’s agreement with the relevant Transmission Customer; and to
- provide a process to be followed by the AER in dealing with the up-front application for a prudent discount.

ETNOF would welcome the Commission’s confirmation that TNSPs will be able to pass through reasonable costs associated with administering and processing each discount application to the discount applicant.

ETNOF also supports the proposed Rules relating to the following matters:

- provisions requiring TNSPs to submit statements of pricing methodology that accord with principles contained in the Rules (Rule 6A.23);
- billing and settlements (Rule 6A.28);
- TNSP prudential requirements (Rule 6A.29);
- provisions governing multiple TNSPs in a region (Rule 6A.30);
- information requirements - regulation of pricing (Rule 6A.31); and
- implementation and enforcement of pricing outcomes (which ETNOF notes will be undertaken by the AER through the exercise of its general monitoring and enforcement powers under the NEL, to ensure that transmission prices are consistent with the applicable approved pricing methodology).

² AEMC, *Rule Proposal Report*, page 10.

As noted above, ETNOF welcomes the Commission's confirmation of its intention that the Proposed Pricing Rule will allow the continuation of existing practices. However, as noted in further detail in this submission, there appear to be a number of important areas in which the Commission's intention is not reflected in the Proposed Pricing Rule. Moreover, there are some areas in which the Proposed Pricing Rule appears not to accommodate existing practices. Accordingly, this submission identifies and examines these areas, and sets out proposed alternative drafting of the relevant Rule that would give effect to the intentions expressed by the Commission in its Rule Proposal Report.

We note that the Commission's view (*that there is no need to alter the substance of the current approach to transmission pricing*) is subject to the outcomes of other reviews currently being undertaken. These reviews include: the congestion management review (CMR); Rule change proposals relating to the Regulatory Test and last resort planning powers; and the Reliability Panel's review of reliability standards and related arrangements.

The outcomes of these reviews - and therefore their potential impact on transmission pricing - are unknown at this time. Against this background, there appears to be some possibility that new transmission pricing Rules will be made in advance of the conclusion of these reviews, and that further subsequent revision of the new transmission pricing Rules may be required after these reviews are finalised. Clearly, such an outcome would be inefficient and most undesirable. ETNOF therefore welcomes the Commission's confirmation that in developing the Proposed Pricing Rule, the Commission has had careful regard to the work presently being undertaken in the other related reviews.

The Commission has sought stakeholder views on the "complementarity" of the transmission pricing and revenue Rules. Sections 3 and 6 of this submission identify some linkages between the revenue and pricing provisions that ought to be considered in more detail. In addition to the issues discussed in these sections, ETNOF notes that the definitions of Prescribed Transmission Services and Negotiated Transmission Services have yet to be satisfactorily resolved. ETNOF expects this particular matter to be progressed during the Commission's finalisation of the transmission revenue Rules.

More generally, ETNOF notes that the Commission has recognised that the revenue and pricing Rules will need to be integrated appropriately prior to finalisation. In this regard, ETNOF notes that there appears to be a need to carefully review the definition of maximum allowed revenue contained in the revenue Rules (clauses 6A.3.1 and 6A.3.2) to ensure that they comprehensively define a TNSP's allowed revenue for prescribed services for a regulatory year. ETNOF would appreciate the opportunity of working with Commission staff in the coming weeks to ensure that this important matter is satisfactorily resolved.

3. DEFINITION OF TERMS IN THE RULES

3.1 Introduction

The Proposed Pricing Rules commence with Rule 6A.22, which:

- comprises an introduction to the transmission pricing rules;
- includes a useful overview of Part J; and
- provides a definition of the relevant terms for Part J.

The clarity of Rule 6A.22 would be improved if the following terms were included in the definition section:

- aggregate annual revenue requirement (AARR);
- annual service revenue requirement (ASRR);
- attributable cost share; and
- attributable connection point cost share.

Although the above terms are currently defined in the introduction section of the Proposed Pricing Rule, their definitions appear in separate clauses (namely, 22.3, 22.4, 22.5 and 22.6, respectively). It is not clear why these terms need to be defined in separate clauses, and doing so makes the introduction section less clear. In addition to this presentational issue, clause 6A.25.2(f) provides for the AER's Guidelines to specify or clarify the application and meaning of *attributable cost share* and the *attributable connection point cost share*. It is not appropriate for the AER's Guidelines to define terms that are critical to the operation of the Pricing Rule. The Pricing Rule should clearly define all the relevant terms.

ETNOF also has material concerns regarding the draft definitions of AARR; ASRR and *attributable connection point cost share*. These definitions prescribe a cost allocation approach that is inconsistent with the existing pricing arrangements. Therefore, if these definitions were implemented, the Proposed Pricing Rule would lead to material changes to transmission prices across the categories of prescribed services. ETNOF does not believe that the AEMC intends its Proposed Pricing Rule to result in substantial change. In fact, as noted earlier, the Rule Proposal Report clearly explains that the existing Rules provide broadly the right outcomes and the Commission's Proposed Pricing Rule is intended to move to a principles-based arrangement and is not intended to require substantive changes to the existing arrangements³.

To explain ETNOF's concerns in detail, the following sections address the definitional issues in turn.

3.2 Aggregate annual revenue requirement (AARR) - Clause 6A.22.3

The draft definition of AARR is set out in clause 6A.22.3 as follows:

"For the purposes of this Part J, the *aggregate annual revenue requirement (AARR)* for *prescribed transmission services* provided by a *Transmission Network Service Provider*, is the *maximum allowed revenue* for that provider for a *regulatory year* of a *regulatory control period*, adjusted:

- (a) in accordance with the adjustments referred to in [draft] clause 6A.3.2;
- (b) for any prudent discount under rule 6A.27;
- (c) for any *over-recovery amount* or *under-recovery amount*; and
- (d) by subtracting the following amounts:
 - (1) estimated revenues from *auction proceeds* distributed to the *Transmission Network Service Provider* under clause 3.18.4 and from *settlements* residue; and
 - (2) operating and maintenance costs incurred in the provision of *common transmission services*."

³ Ibid, page 14.

The Commission explains in its Rule Proposal Report⁴ that the proposed approach to defining the AARR differs from current practice in the existing Rules. Under the present Rules, adjustments to the amount of revenue that TNSPs are entitled to recover in a particular year through charges for Prescribed Transmission Services are reflected only in the magnitude of Customer TUOS charges. In this light, the Commission explains the rationale for its proposed approach as follows⁵:

“The Commission considers that it is more appropriate for all adjustments to the amount of revenue that may be recovered from Prescribed Transmission Service charges are made at the outset, directly to the AARR, rather than through the Customer TUoS General Charge. Although the Commission understands that this will involve a degree of rebalancing of charges, it should improve the clarity of the price-setting process. The Commission seeks stakeholder views on whether any rebalancing of charges is likely to result in significant undesirable implications for particular types or locations of network users.”

ETNOF does not agree that the proposed changes will improve the clarity of the price-setting process. In addition, for the reasons set out in further detail below, ETNOF does not agree that the approach proposed by the Commission is more appropriate than the present practice.

Firstly, the Commission has not fully appreciated the impact of its proposed approach on the balance of transmission revenue across the prescribed services categories. In particular, deducting the intra-regional and inter-regional settlements residues and under/over-recovery amount from the total revenue requirement has the effect of passing a proportion of these amounts to generators, even though the residues and under/over-recovery amount have been primarily derived from load customers. Not only does this raise issues of fairness, but it would also lead to a substantial reduction in entry and exit charges, and an off-setting increase in TUOS charges.

Secondly, in addition to the issue of the settlements residue, two other aspects of the AARR definition appear to be potentially confusing or inappropriate. In particular:

- The deduction of prudent discounts from the annual revenue entitlement is potentially confusing because prudent discounts, by definition, should have no effect on the overall revenue entitlement. We note that the Proposed Pricing Rule appears to be intended to allow prudent discounts to be added back to the revenue entitlement through clause 6A.27.1(c), but overall the drafting is unclear.
- Similarly, the deduction of operating and maintenance costs incurred in the provision of common transmission services may also create confusion. In contrast to prudent discounts, however, it does not appear this operating and maintenance cost is allowed to be added back through a later clause (although presumably, it should be added back through clause 6A.24.3(c)(2)).

ETNOF recommends that the difficulties with the proposed definition of “AARR” be overcome by defining the AARR as *the revenue that the TNSP is entitled to recover for the provision of prescribed services for the regulatory year*. It is noted that this amount is already defined by clause 6A.3.1 in the draft revenue Rules as follows:

“The revenue that a *Transmission Network Service Provider* may earn in any *regulatory year* of a *regulatory control period* from the provision of *prescribed transmission services* is the

⁴ Ibid, page 55

⁵ Ibid, page 56

maximum allowed revenue and any adjustments referred to in clause 6A.3.2, and is to be determined in accordance with:

- (1) the *revenue cap determination* forming part of the applicable *transmission determination*; and
- (2) the provisions of this Part C.”

The reference in 6A.3.1(2) to “Part C” is a reference to the pricing Rules. ETNOF believes that it would be better if the revenue amount that a TNSP is allowed to recover in a regulatory year is defined by the revenue Rules, without any reference to the pricing Rules. On this basis, ETNOF believes that sub-clause (2) should be deleted, and appropriate consequential changes, if any, should be made to the revenue Rules.

In this context, it is noted that together, clauses 6A.3.1 and 6A.3.2 define *maximum allowed revenue*. These clauses appear to contain circular cross-references. ETNOF would expect the revenue provisions in clause 6A.3.1 to comprehensively define a TNSP’s allowed revenue for prescribed services for a regulatory year. Given these observations, there appears to be a need to review the drafting of clauses 6A.3.1 and 6A.3.2 to ensure that they provide a clear definition of the total revenue that is to be recovered through the pricing methodology in any given year.

The task of the pricing Rules should then be to establish principles for how each TNSP should set prices to recover its allowed revenue for prescribed services for a regulatory year. On this basis, as noted above, the definition of AARR should simply reference clause 6A.3.1. This suggested approach would substantially simplify the current definition of the AARR, which unnecessarily seeks to apply a series of adjustments to the maximum allowed revenue (MAR).

ETNOF notes that it is particularly important that the revenue Rules contain a clear definition of AARR, as this will ensure that TNSPs are legally entitled to recover a level of prescribed services revenue - inclusive of all adjustments - in each year of a regulatory control period even when such adjustments lead to a revenue requirement that may exceed MAR in a given year. Accordingly, ETNOF would appreciate the opportunity of working with Commission staff in the coming weeks to ensure that this important matter is satisfactorily resolved.

In summary, ETNOF recommends the following definition of the AARR:

“Aggregate annual revenue requirement (AARR) means the revenue that the TNSP is entitled to recover for the provision of prescribed services for the regulatory year in accordance with clause 6A.3.1.”

It is noted that the annual service revenue requirement (ASRR) is defined as follows:

“For the purposes of this Part J, the annual service revenue requirement (ASRR) for a Transmission Network Service Provider is the portion of the AARR for prescribed transmission services provided by a Transmission Network Service Provider that is allocated to each category of prescribed transmission services for that provider and that is calculated by the multiplication of the AARR by the attributable cost share for that category of services in accordance with the principles in clause 6A.24.2.”

ETNOF considers this definition is appropriate.

However, ETNOF’s proposed definition of AARR gives rise to the need for some re-drafting of the principles for the allocation of the ASRR to transmission network connection points (clause 6A.23.3), to ensure that adjustments relating to over-recovery amounts, under-

recovery amounts, settlements residue and auction proceeds are allocated to the appropriate component of the TUOS ASRR. This matter is addressed in section 4.3 below.

3.3 Attributable cost share - Clause 6A.22.5

The draft definition of *attributable cost share* is set out in clause 6A.22.5 as follows:

“For a *Transmission Network Service Provider* for a *category of prescribed transmission services*, the *attributable cost share* for that provider for that category of services must, subject to any adjustment required under the principles in clause 6A.24.3, include or reflect either or both of:

- (a) a ratio of the costs of the *transmission system* assets directly attributable (on a causation basis) to the provision of a *category of prescribed transmission services*, as a proportion of the total costs of all the *Transmission Network* (on a causation basis) to the provision of *prescribed transmission services*; and
- (b) a ratio of operating and maintenance costs directly attributable (on a causation basis) to the provision of a *category of prescribed transmission services*, as a proportion of all of the *Transmission Network Service Provider’s* operating and maintenance costs directly attributable (on a causation basis) to the provision of *prescribed transmission services*;

where “costs of the *transmission system* asset” is referable to values contained in the accounts of the *Transmission Network Service Provider*.”

The Commission commented in its Rule Proposal Report on the definition of *attributable cost share* as follows⁶:

“In comparing the Proposed Rule definition of “*attributable cost share*” to existing arrangements it allows for both innovation and the continuation of existing practice.”

The Commission summarised its intention regarding the definition of *attributable cost share* as follows⁷:

“It is the Commission’s view that, taken together, the Proposed Rules will safely accommodate the existing arrangements where the AARR allocation is based on the relative ORC of the assets developed to provide a particular Prescribed Transmission Service. However, the Proposed Rule provisions will also allow alternative approaches so long as they are based on a well-accepted conception of the relative cost or value of the relevant asset and other expenditures directly attributable (on a causation basis) to the provision of a service. That is, the Commission does not wish to require TNSPs to maintain ORC asset accounts purely for the sake of developing transmission prices, so long as they maintain databases of other suitable measures of asset cost. The purpose of allowing TNSPs to propose alternative allocation approaches is to potentially improve at least the long-term cost-reflectivity of the charges for Prescribed Transmission services.”

ETNOF is concerned that the proposed definition of *attributable cost share* does not give effect to the Commission’s intentions. In particular:

- The proposed drafting of the Rules does not describe principles for allocation, but instead mandates a choice of two broad allocation methods. It would be more appropriate to require the TNSPs to have regard to some high-level pricing objectives in determining the

⁶ Ibid, page 52

⁷ Ibid, page 53

attributable cost share methodology. For example, clause 6.1.1(c) in the current Chapter 6 Rules describes the core objectives for the pricing arrangements as follows:

“The core objectives intended to be achieved by the application of the *transmission* and *distribution* pricing arrangements in this Chapter are:

- efficiency in the use, operation, and maintenance of, and investment in, the network, and in the location of generation and demand;
 - upstream and downstream competition;
 - price stability; and
 - equity.”
- The *attributable cost share* is defined subject to “any adjustment required under the principles in clause 6A.24.3”. However, clause 6A.24.3 describes the principles for the allocation of the ASRR to transmission network connection points. As the ASRR is the product of the AARR and the *attributable cost share*, it is unclear how clause 6A.24.3 can be relevant for defining the *attributable cost share*.
 - Under the present drafting, an allocation using asset values refers to “the values contained in the accounts of the TNSP.” It should be noted that a TNSP may not include ORC values in its accounts, and therefore the proposed drafting would not allow a continuation of existing allocation practices. More generally, the Rule Proposal Report clearly suggests that alternative asset valuations may provide an appropriate basis for allocation providing that the TNSP “maintain databases of other suitable measures of asset cost.” Therefore, it appears that the proposed definition of *attributable cost share* is unintentionally restrictive.
 - Under the present drafting, the direct attribution of costs on a causation basis may not produce appropriate outcomes in all situations. For example, a TNSP may have a substation that supplies a single load customer, and a second customer wants to connect to that substation. The only change to the assets at the substation to accommodate the second customer will be construction of an additional feeder bay. Application of the principle of attributing costs on a causation basis suggests that the existing customer would continue to pay for the existing substation assets (which were constructed for its sole use) while the new customer only pays for the new feeder bay (even though the new customer will use some of the other assets in the substation). Were such an approach to be adopted, this would represent a material change to the present cost allocation arrangements. Such outcomes would appear to be an unintended consequence of applying the proposed principle of allocating costs on a causation basis.

ETNOF believes that the proposed definition of *attributable cost share* should be amended to better reflect the Commission’s stated intentions, and to accommodate current practice. To address these concerns, ETNOF suggests that the definition of *attributable cost share* set out below would be more appropriate. Please note that suggested changes are marked for ease of reference.

“For a *Transmission Network Service Provider* for a *category of prescribed transmission services*, the *attributable cost share* ~~for that provider for that category of services must, subject to any adjustment required under the principles in clause 6A.24.3, include or reflect either or both of~~ is the portion of AARR that is to be recovered from that category of prescribed transmission services, calculated on a reasonable basis using one of the following methods:

- (a) the a ratio of the costs of the *transmission system* assets directly attributable (on a causation basis) to the provision of a *category of prescribed transmission services*, as a

proportion of the total costs of all the *Transmission Network* (on a causation basis) to the provision of *prescribed transmission services*; or

- (b) ~~the~~ a ratio of operating and maintenance costs directly attributable (on a causation basis) to the provision of a *category of prescribed transmission services*, as a proportion of all of the *Transmission Network Service Provider's* operating and maintenance costs directly attributable (on a causation basis) to the provision of *prescribed transmission services*; or
- (c) some other method or combination of methods which gives effect to the pricing objectives, {see existing clause 6.1.1(c) in the current Chapter 6 Rules} and which provide an appropriate allocation of any *network support pass through amount*, or *over-recovery amount* or *under-recovery amount*;

where “costs of the *transmission system asset*” ~~is referable to values contained in the accounts of the Transmission Network Service Provider~~ fairly reflects an accepted valuation method.”

3.4 Attributable connection point cost share - Clause 6A.22.6

ETNOF understands that the purpose of the *attributable connection point cost share* is to allocate the revenue that is recoverable from entry and exit services across the relevant connection points. On the basis of this understanding, there appears to be a minor drafting error in the introductory words of clause 6A.22.6, as the clause should refer to entry and exit services only rather than a *category of prescribed transmission services*.

More importantly, the definition of *attributable connection point cost share* does not presently give effect to the Commission’s objective of adopting a principles-based approach. Relatively minor drafting changes would clarify the intention of the clause and provide TNSPs with additional comfort that existing pricing practices can be accommodated. In particular, ETNOF recommends that identical wording is used in clauses 6A.22.5 and 6A.22.6 to explain the meaning of “costs of the *transmission system asset*”. ETNOF’s suggested definition of *attributable connection point cost share* is set out below. Suggested changes are highlighted for ease of reference.

~~“For a Transmission Network Service Provider, for a category of prescribed transmission services, the attributable connection point cost share for that provider for that category of services must include or reflect either or both of: allocates the ASRRs attributable to entry services and exit services to the relevant connection points on a reasonable basis using one of the following methods:~~

- (a) the ratio of the costs of the *transmission system assets* directly attributable (on a causation basis) to the provision of *prescribed entry services* or *prescribed exit services* at a *transmission network connection point*, as a proportion of the costs of all the *Transmission Network Service Provider's transmission system assets* directly attributable (on a causation basis) to the provision of *prescribed entry services* or *prescribed exit services*; or
- (b) a ratio of operating and maintenance costs directly attributable (on a causation basis) to the provision of *prescribed entry services* or *prescribed exit services* at a *transmission network connection point*, as a proportion of all the *Transmission Network Service Provider's* operating and maintenance costs directly attributable (on a causation basis) to the provision of *prescribed entry services* or *prescribed exit services*; or
- (c) some other method or combination of methods which gives effect to the pricing objectives {see existing clause 6.1.1(c) in the current Chapter 6 Rules};

where “costs of the *transmission system asset*” ~~is referable to values contained in the accounts of the Transmission Network Service Provider~~ fairly reflects an accepted valuation method.”

3.5 Titles of the four categories of prescribed transmission services

The term “categories of prescribed transmission services” is defined in the definitions section (clause 6A.22.2) of the Rules as meaning, for the purposes of pricing:

- (a) prescribed entry services;
- (b) prescribed exit services;
- (c) common transmission services;
- (d) prescribed transmission use of system services.

It is noted that the title of each of the four categories of prescribed transmission services except for “Common transmission services” contains the word “prescribed”.

It is suggested that to avoid confusion, the titles of all four categories of prescribed transmission services should each contain the word “prescribed”.

4. PRICING PRINCIPLES – RULE 6A.24

4.1 Introduction

Rule 6A.24 sets out the three steps that comprise the transmission pricing methodology:

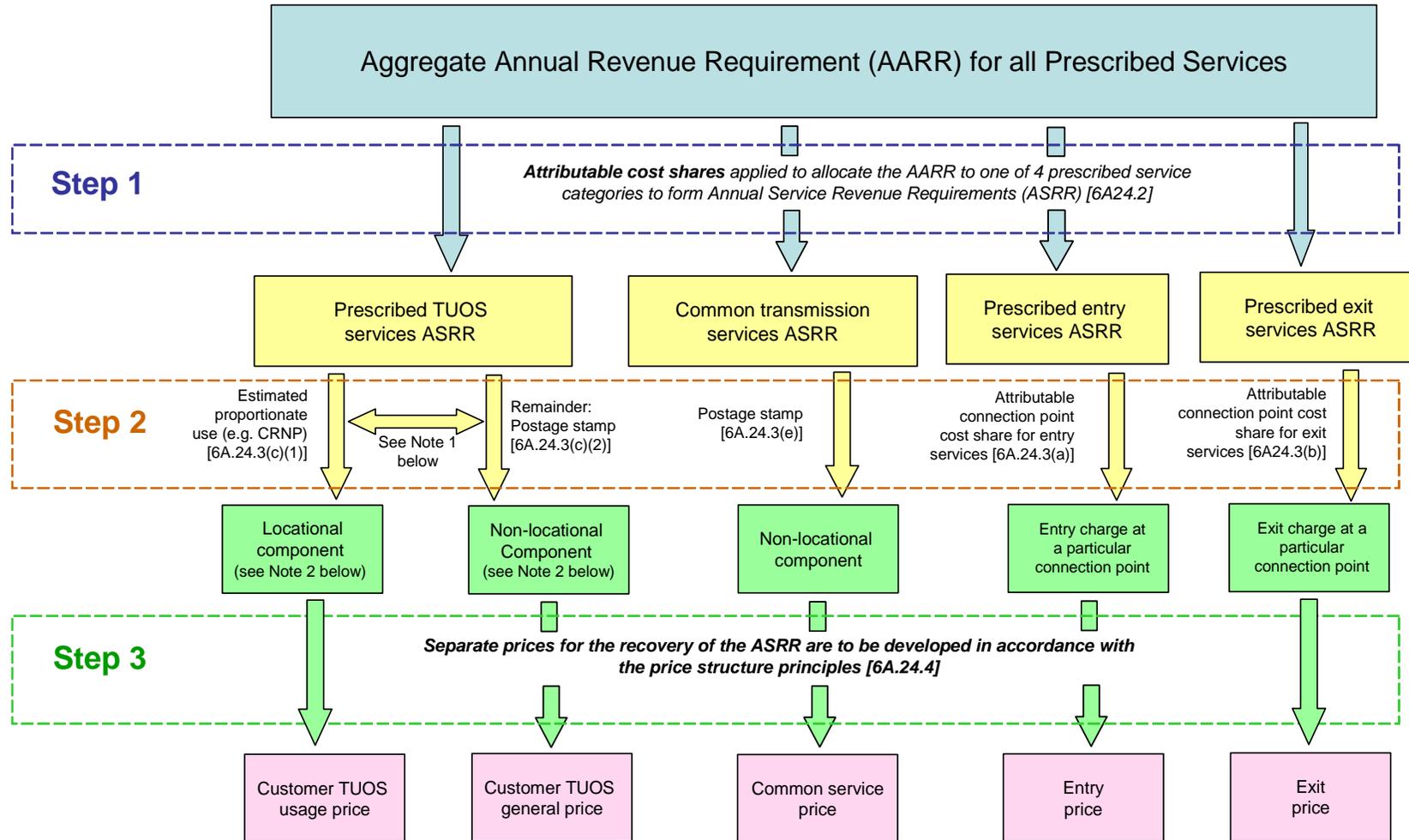
- Step 1: Principles for the allocation of the AARR to categories of prescribed transmission services – clause 6A.24.2;
- Step 2: Principles for the allocation of the ASRR to transmission network connection points – clause 6A.24.3; and
- Step 3: Price structure principles – clause 6A.24.4.

Section 3 of this submission proposes changes to the definitions of the AARR, attributable cost share and attributable connection point cost share, which would substantially improve the operation of the three steps outlined in Rule 6A.24. As noted earlier, one important consequence of the changes proposed by ETNOF would be to better reflect the Commission’s intention to develop a Proposed Pricing Rule that confirms the continued operation of current pricing methodologies while also providing scope for innovation into the future⁸.

In addition to the proposed changes to the definitions, ETNOF believes that changes are also required to Step 1 (clause 6A.24.2), along with some minor changes to Step 3 (clause 6A.24.4). ETNOF’s proposed changes are explained below. Before turning to these important points of detail, it is also worth noting that the Proposed Pricing Rule would benefit from a diagram that provides an overview of the three steps. This type of diagram is included in the existing chapter 6 Rules, and does assist in aiding understanding. ETNOF has prepared the diagram below for consideration by the Commission.

⁸ Ibid, preface ix

Method for allocating revenue (costs) under proposed Transmission Pricing Rules



Note 1: A 50/50 ratio is to be applied to determine the allocation between locational and non-locational components, or an alternative sharing ratio is to be applied that is based on a reasonable estimate of future use and likely need for future investment, with the aim of providing more efficient locational signals. [6A.24.3(d)]

Note 2: Any over-recovery amount or under-recovery amount is to be allocated to the non-locational component. [ETNOF's proposed clause 6A.24.3(d)]
 Estimated revenues from auction proceeds and from settlements residue are to be applied to reduce the locational component and/or the non-locational component in a manner consistent with the pricing objectives. [ETNOF's proposed clause 6A.24.3(e)]

4.2 Principles for the allocation of the AARR to categories of prescribed transmission services – clause 6A.24.2

The Commission explains its principles for the allocation of the AARR to categories of prescribed transmission services in the following terms⁹:

“The AARR for a given year is to be allocated as follows:

- in accordance with the *attributable cost share* for each pricing category of Prescribed Transmission Services;
- so that the same portion of AARR cannot be allocated more than once;
- where a portion of the AARR can be allocated to more than one pricing category of Prescribed Transmission Service, it is to be allocated according to the priority ordering outlined in the Rules.”

The Rule Proposal Report further explains the concept of priority ordering as follows¹⁰:

“The Proposed Pricing Rule sets out priority principles for adjusting the attributable cost share where a particular asset or O&M expenditure could potentially be attributed to more than one Prescribed Transmission Service category. The intention is that the asset or expenditure should be:

- first, allocated to Prescribed Entry or Exit Services, to the extent that the relevant asset or expense is necessary to provide these services on a standalone basis; and
- then, if there is any remainder, allocated to Prescribed TUoS Services, to the extent that the relevant asset or expense is necessary to provide these services on a standalone basis; and
- ultimately, if there is any remainder, allocated to Common Transmission Services.”

The Rule Proposal Report also makes the following comments that are relevant to the issue of classifying assets between different prescribed service categories:

- Reclassification of services should be avoided¹¹:

“As the Proposed Rule emphasises attribution to the service that causes the development of the relevant asset or the incurring of the relevant O&M expenditure, it should also avoid the issue raised by Stanwell of common service assets being reclassified as entry assets at a later point in time. Attribution based on causation implies that attribution does not change if and when the use of the asset (or subject of the expenditure) changes.”

- The Commission supports shallow connection policy¹²:

“On the issue of deep versus shallow connection, Macquarie Generation, NSPMA, Origin Energy, Citipower/Powercor and UED supported the current shallow connection regime, in which generators do not contribute to downstream network augmentation costs that follow from their connection.”

⁹ Ibid, page 51.

¹⁰ Ibid, page 54.

¹¹ Ibid, page 53.

¹² Ibid, pages 38 and 41.

“On the issue of deep connection charges, the Commission agrees with the views of TransGrid, Macquarie Generation, EnergyAustralia and Origin that deep connection charges may create additional regulatory complexity and deter new generation investment, thereby harming competition and the long-term interests of end-use consumers.”

- The Commission considers that VENCORP’s guidelines make a valuable contribution to the debate on the appropriate delineation between assets that provide Prescribed Transmission Services and those that provide Negotiated Transmission Services¹³:

“In general, the guidelines provide for connecting parties to pay for the costs of augmentations necessary to enable their connection to meet an automatic, minimum or negotiated access standard.”

ETNOF understands that the delineation between service categories is a complex issue, and there is no single objectively correct approach. It is noteworthy that the comments made by the Commission in its Rule Proposal Report (and importantly, clause 6A.24.2) are not internally consistent. In particular:

- the reclassification of assets from shared to connection is not intended to be permitted under the Proposed Pricing Rule, but it is not clear whether reclassifying a connection asset to a shared asset is allowed;
- the VENCORP guidelines are not consistent with a ‘pure’ shallow connection policy because a generator may be required to contribute to investment in the shared network. Therefore, the VENCORP guidelines are not necessarily consistent with the Commission’s preference for a shallow connection policy; and
- practical application of the priority ordering and standalone concepts described in clause 6A.24.2 may well lead to services being reclassified over time, which appears to be contrary to the intention outlined in the Rule Proposal Report.

Notwithstanding the apparent differences in the views expressed by the Commission in its Rule Proposal Report, ETNOF has serious concerns in relation to the practicality of clause 6A.24.2(c), which describes the priority ordering. In particular, applying the priority ordering to define the prescribed transmission services categories would be a major exercise, and would require substantial guidance from the AEMC or AER in order to ensure a broadly consistent approach across transmission networks. Furthermore, from a practical perspective TNSPs have already adopted reasonable methods for delineating between prescribed transmission services. Therefore, if clause 6A.24.2(c) is intended to require TNSPs to revisit the existing delineation between prescribed transmission service categories, it is an unwelcome and unnecessary exercise.

On the basis of the above discussion, ETNOF strongly recommends that clause 6A.24.2(c) be amended as follows:

“6A.24.2 Principles for the allocation of the AARR to categories of prescribed transmission services

The *aggregate annual revenue requirement (AARR)* for *prescribed transmission services* provided by a *Transmission Network Service Provider* is to be allocated in accordance with the following principles:

- (a) The AARR for a *Transmission Network Service Provider* must be allocated to each *category of prescribed transmission services* in accordance with the *attributable*

¹³ Ibid, page 42.

cost share for each such category of services. This allocation results in the *annual service revenue requirement (ASRR)* for that category of services.

- (b) The allocation of the *AARR* must be such that the same portion of the *AARR* is not allocated more than once.
- (c) Where, as a result of the application of the *attributable cost share*, a portion of the *AARR* would be attributable to more than one category of *prescribed transmission services*, that *attributable cost share is a share of the cost of the asset that is determined in a manner consistent with the pricing objectives {see existing clause 6.1.1(c) in the current Chapter 6 Rules}*. ~~to be adjusted and applied such that any costs of a transmission system asset or operating and maintenance cost that would otherwise be attributed to the provision of more than one category of prescribed transmission services, is allocated as follows:~~
- ~~(1) to the provision of prescribed entry services and prescribed exit services, but only to the extent of the stand-alone amount for those categories of prescribed transmission services;~~
 - ~~(2) if any portion of the costs of a transmission system asset or operating and maintenance cost is not allocated to prescribed entry services and prescribed exit services under subparagraph (1), that portion is to be allocated to prescribed transmission use of system services, but only to the extent of the stand-alone amount for that category of prescribed transmission services; and~~
 - ~~(3) if any portion of the costs of a transmission system asset or operating and maintenance cost, is not attributed to prescribed transmission services under subparagraphs (1) and (2), that portion is to be attributed to common transmission services. "~~

TNSPs should be allowed to continue to apply their own methods for delineating between categories of prescribed transmission services. In this regard, it is noted that certain parts of the existing Rules provide reasonably clear high-level statements that can be applied to guide decisions regarding the delineation between different categories of service. For instance, clause 6.3.1 (a) states:

"The classes of transmission services are:

- (1) entry service which includes those services provided to serve a Generator or group of Generators at a single connection point;
- (2) exit service which includes those services provided to serve a Transmission Customer or group of Transmission Customers at a single connection point;
- (3) transmission use of system service; and
- (4) common services which are services that maintain power system security and benefit all Transmission Customers and which cannot reasonably be allocated on a location basis."

Schedule 6.2 defines the different categories of costs (which correspond to the different classes of transmission service) as follows:

- "costs which relate to the provision of assets to provide service to the overall transmission system and any non asset related costs which it is not appropriate to allocate to users on a locational basis (called common service);
- the cost of providing assets which are fully dedicated to providing connection to a single Generator or group of Generators connected at a single point within the transmission network (called entry assets);

- the cost of providing assets which are fully dedicated to the supply of a single Transmission Customer or group of Transmission Customers connected at a single point within the transmission network (called exit assets);
- the cost of assets which are shared to a greater or lesser extent by all users across the transmission system, including those costs associated with new transmission network investment other than those allocated to specific Generators in accordance with schedule 6.8 (called transmission network assets)."

In relation to the matter of identifying entry and exit assets, Schedule 6.2 states:

"The entry and exit asset costs are recovered from the Transmission Network Users who benefit from them and requires no complex analysis to determine the sharing.

A "shallow connection asset" policy is to be adopted in which only those assets (including individual assets within a substation) which provide supply to only those Transmission Network Users connected at the connection point are included. This is a simple definition, which avoids the difficulties that can be caused by a "deeper connection asset" policy where assets may change from connection assets to becoming part of the transmission network.

Consequently entry and exit assets include only substation assets, including transformers, which are used to supply load at the interface between Transmission Network Users and the transmission network. However the Transmission Network Service Provider may require the Transmission Network User to meet all the network charges for radial transmission lines.

Transmission lines connecting Generators to the Transmission Network Service Provider's assets may be assets of the Generator. Where such are owned by the Transmission Network Service Provider they are to be treated as connection assets.

Some substation establishment and building costs are to be recovered through entry and exit charges."

The guidance provided by the existing Rules has enabled TNSPs to delineate between the prescribed transmission services categories without major difficulties. In this light, ETNOF cautions against the adoption in the Rules of new allocation procedures based on economic concepts such as standalone costs, which are typically difficult to apply in practice. As noted above, amendment of clause 6A.24.2(c) is therefore recommended. To the extent required, further guidance governing the delineation between the prescribed transmission services categories could then be provided through the Pricing Methodology Guidelines.

4.3 Principles for the allocation of the ASRR to transmission network connection points - clause 6A.24.3

In section 3.2 of this submission, ETNOF outlined the reasoning underpinning its proposed definition of AARR. Given the reasoning set out in section 3.2, ETNOF strongly recommends that clause 6A.24.3 be amended as shown below:

"The *annual service revenue requirement (ASRR)* for a *Transmission Network Service Provider* for each *category of prescribed transmission services* is to be allocated to each *transmission network connection point* in accordance with the following principles:

- (a) The whole of the *ASRR* for *prescribed entry services* is to be allocated to a *transmission network connection point of a Generator* in accordance with the *attributable connection point cost share* for *prescribed entry services* that are provided by the *Transmission Network Service Provider* at that *connection point*.
- (b) The whole of the *ASRR* for *prescribed exit services* is to be allocated to *transmission network connection points of Transmission Customers* in accordance with the *attributable connection point cost share* for *prescribed exit services* that

are provided by the *Transmission Network Service Provider* at that *connection point*.

- (c) Subject to paragraphs (d), (e) and (f), the ASRR for *prescribed transmission use of system services* is to be allocated to *transmission connection points of Transmission Customer* in the following manner:
- (1) a portion of the ASRR (the **locational component**) is to be allocated as between such *Transmission Customer connection points* on the basis of the estimated proportionate use of the relevant *transmission system assets* by each of those customers and providers, and the *CRNP methodology* and *modified CRNP methodology* represents two permitted means of estimating proportionate use; and
 - (2) the remainder of the ASRR (the **non-locational component**) is to be allocated as between such *Transmission Customer connection points* by the application of a *postage-stamped price*.
- (d) In the case of the ASRR for *prescribed transmission use of system services*, the shares of the locational and non-locational components are to be either:
- (1) a 50% share allocated to each component; or
 - (2) an alternative allocation to each component, that is based on a reasonable estimate of future network utilisation and the likely need for future transmission investment, and that has the objective of providing more efficient locational signals to *Market Participants, Intending Participants* and end-users.
- Any over-recovery amount or under-recovery amount is to be allocated to the non-locational component.
- (e) Estimated revenues from auction proceeds distributed to the Transmission Network Service Provider under clause 3.18.4 and from settlements residue are to be applied to reduce the locational component and/or the non-locational component of the ASRR for prescribed transmission use of system services in a manner consistent with the pricing objectives {see existing clause 6.1.1(c) in the current Chapter 6 Rules}.
- (e)(f) The ASRR for *common services* must be allocated to *Transmission Customer and Network Service Provider connection points* by the application of a *postage-stamped price*.”

4.4 Price structure principles - 6A.24.4

ETNOF generally supports the Commission’s approach to ‘step 3’ in the pricing methodology, which is the establishment of prices to recover the ASRR for each prescribed service category.

ETNOF considers that the inclusion of the terms “price” and “charge” in brackets in clause 6A.24.4(b)(1)-(5) is unnecessary, and that the intention of the drafting of these provisions is unclear.¹⁴ ETNOF therefore proposes that the description in brackets in each of the clauses should be deleted.

In addition, ETNOF’s view is that the meaning of “fixed annual amount” should be clarified to avoid any potential confusion regarding the intention. ETNOF’s proposed drafting changes are shown below.

¹⁴ It is acknowledged that a similar lack of clarity regarding the usage and meaning of the terms “price” and “charge” presently exists in clause 6.3.1 of the Rules.

- “(a) A *Transmission Network Service Provider* is to develop separate prices for the recovery of the ASRR in accordance with the principles set out in paragraphs (b)-(g).
- (b) Separate prices are to be developed for each *category of prescribed transmission services*, being:
- (1) *prescribed entry services* (~~prescribed entry service price, prescribed entry service charge~~);
 - (2) *prescribed exit services* (~~prescribed exit service price, prescribed exit service charge~~);
 - (3) *common transmission services* (~~common transmission service price; common transmission service charge~~);
 - (4) *prescribed transmission use of system services* – locational component (~~Customer TuoS usage price; Customer TUOS usage charge~~); and
 - (5) *prescribed transmission use of system services* – non-locational component (~~Customer TuoS general price; Customer TUOS general charge~~).
- (c) Prices for *prescribed entry services* and *prescribed exit services* must be a fixed amount per annum, meaning that the price should not vary with energy usage or demand.
- (d) Prices for *common transmission services* must be *postage-stamped*.
- (e) Prices for recovering the locational component of providing *prescribed use of system services* must be based on demand or consumption at times of greatest utilisation of the *transmission network* and for which *network* investment is most likely to be contemplated.
- (f) Prices for recovering the locational component of the ASRR for the provision of *prescribed transmission use of system services* must not change by more than 2 per cent per annum compared with the load weighted average price for this component for the relevant *region*.
- (g) Prices for recovering the non-locational component of providing *prescribed transmission use of system services* must be *postage-stamped*.”

Finally, ETNOF notes that it has some practical concerns with the application of the 2% rule contained in clause 6A.24.4(f) because there may be instances in which the application of the 2% constraint would give rise to inappropriate outcomes. For instance, if there is a step change in load (such as a mining load increasing from say, 5 MW to 20 MW), then depending on the structure of the price, it may not be appropriate to constrain the resetting of the locational TUOS price in the manner set out in clause 6A.24.4(f). Any “side constraint” such as that set out in clause 6A.24.4(f) should be specified in a way that does not provide customers with an incentive to initially understate the level of demand they require. ETNOF would appreciate the opportunity of working with the Commission during the next phase of development of draft pricing Rule to ensure that any potential issues associated with the specification of pricing “side constraints” are addressed.

5. PRICING METHODOLOGY GUIDELINES

5.1 Introduction

As noted in our response to the November 2005 Transmission Pricing Issues Paper, ETNOF would have preferred a continuation of the existing Rules, as this would have minimised regulatory costs both for the TNSPs and the AER. Nonetheless, ETNOF accepts the Commission’s proposal that the current pricing Rules be revised to a principles-based regulatory framework in which implementation of the elements of the regime is left to the

guided discretion of TNSPs and the AER. ETNOF also strongly endorses the Commission's intention that the change should "enhance clarity and promote certainty over the implementation of the pricing arrangements for TNSPs and their customers"¹⁵.

However ETNOF is concerned with the proposal (reflected in clause 6A.25.2(f)) that the AER's guidelines should define terms such as *attributable cost share*, and the *attributable connection point cost share*. As noted in section 3 of this submission, ETNOF considers that such terms should be clearly defined in the Rules. Moreover, ETNOF's view is that requiring the AER's guidelines to establish the meaning of these terms is inconsistent with the Commission's intention to enhance clarity and promote certainty over the implementation of the pricing arrangements.

Given these considerations, ETNOF recommends changes to clause 6A.25.2, as shown below.

5.2 ETNOF suggested changes to pricing methodology guidelines – Rules 6A.25

ETNOF's suggested changes to the Pricing Methodology Guidelines Rules are shown highlighted below.

“6A.25.2 Contents of Pricing Methodology Guidelines

The *Pricing Methodology Guidelines* may specify or clarify:

- (a) the form which a proposed *pricing methodology* is to take;
- (b) the information that is to accompany a proposed *pricing methodology* being information that is necessary to allow the *AER* to form a view as to whether the proposed *pricing methodology* is consistent with and gives effect to, the *Pricing Principles* and the requirements of this Part J;
- (c) what parts (if any) of a proposed *pricing methodology* or the information accompanying it, will not be publicly disclosed without the consent of the *Transmission Network Service Provider*;
- (d) the types of *transmission system* assets and operating and maintenance costs that are typically developed or incurred in providing the different *categories of prescribed transmission services*;
- (e) the operation and application of the *CRNP methodology* and *modified CRNP methodology* as described in schedule 6A.4; and
- (f) any other aspect of the pricing methodology, including the application and meaning of the *attributable cost share*, the *attributable connection point cost share*, the *stand-alone amount* and "directly attributable (on a causation basis)".

6. PROCEDURE FOR APPROVAL OF PRICING METHODOLOGY

The Rule Proposal Report explains that the Commission has sought to develop and codify regulatory procedures that correspond to those adopted in the Draft Revenue Rule. 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 the methodology 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 the AER is empowered to substitute a different or modified methodology.

¹⁵ Ibid, page 14.

As part of a decision to approve the proposed pricing methodology, the AER is required to consult with, and take into consideration any comments received from interested parties. The Rule Proposal Report explains that the Commission considers this increased level of consultation will promote greater transparency in the approach to transmission pricing.

ETNOF broadly supports the Commission's view that the pricing methodology should be submitted alongside the revenue cap submission. ETNOF notes the Commission's view that¹⁶:

"This integration of processes allows for a streamlined and efficient regime for the TNSP to propose its pricing methodology, and at the same time will allow market participants and the regulator to obtain a better overall understanding of the links between revenue and pricing and the overall impact of the transmission determination."

Notwithstanding the Commission's comments regarding the integration of pricing methodology and revenue cap determinations, ETNOF's principal concern is that the proposed procedures for approval of the pricing methodology creates timing issues. For instance, some TNSPs are required to submit final prices to DNSPs prior to late March each year, to enable DNSPs to submit their proposed DUOS and TUOS prices to the regulator on 1 April for approval. The Proposed Pricing Rule provides for the AER's final approval of a TNSP's pricing methodology by April or May, some weeks after the TNSP must have applied the approved methodology, calculated all prices and advised the relevant DNSPs.

This example highlights the practical difficulties associated with the Rule 6A.26. Given these difficulties, ETNOF welcomes the Commission's drafting notes in Rule 6A26.14, in which the Commission seeks comment as to the appropriate timing requirements for a Transmission Network Service Provider to publish its annual prices based on its pricing methodology. In effect, the current drafting of the Rules requires:

- the review and approval process for pricing and revenue to be conducted at the same time; and
- the approved pricing methodology to apply at the start of the regulatory period.

The example described above shows that in some cases, it will not be possible to meet both of these requirements. More broadly, the processes of preparing pricing methodology and revenue cap submissions, and then setting new prices and (potentially) implementing a revised pricing methodology are relatively resource intensive and time-sensitive.

There are three possible solutions to address these issues:

- bring forward the timing of the approval process for the pricing methodology, to enable that process to be completed in advance of the revenue cap determination process. This would enable a spreading of the workload associated with TNSPs preparing, and the AER reviewing, pricing methodology and revenue cap submissions. It would also enable any required revisions to the pricing methodology to be implemented well in advance of the timing of the final revenue cap decision and the subsequent production by the TNSP of final transmission prices in accordance with the approved pricing methodology; or
- retain the present requirement for concurrent review and approval of the pricing methodology and revenue cap proposal, but allow the new pricing methodology to be implemented in the second year of the relevant regulatory period (and to then apply for a 5 year period); or

¹⁶ Ibid, page 67.

- abandon the requirement for the pricing methodology and revenue cap approval processes to be linked.

At this stage, ETNOF has no particular preference in relation to these three potential solutions. As noted above, there is a need to address the timing and resourcing issues arising from the present proposal to integrate the approval processes for pricing methodology and the associated revenue cap. ETNOF would welcome the opportunity of discussing these matters in further detail with the Commission prior to the publication of the Draft Pricing Rule.

7. OTHER MATTERS

7.1 Confidentiality of information

ETNOF notes that in a drafting note to Rule 6A.32, the Commission seeks comment as to an appropriate regime for dealing with confidentiality of information in light of the proposed changes to the pricing regime. As a minimum, individual entry prices and non-DNSP exit prices should be confidential because of their commercial sensitivity, and therefore an amendment to proposed Rule 6A.26.14 may be required.

More generally, the Rules should provide the AER with appropriate flexibility to determine how matters of confidentiality in relation to pricing should be addressed. It is important, however, that the Rules also require the AER to consult with TNSPs on matters of confidentiality, prior to publishing pricing information.

7.2 Transition and saving provisions

It can be inferred from the Proposed Pricing Rules and the Rule Proposal Report that the new transmission pricing rules are not intended to apply to a TNSP until the expiry of that TNSP's existing revenue cap. This is confirmed by Clause 11.5.3 of the draft transmission revenue Rules, which states:

“Subject to this rule 11.5, old Part C (including Schedules 6.2, 6.3, 6.4, 6.7 and 6.8) continues to apply for the duration of a current regulatory control period.”]

As noted in section 6, the Commission proposes that the pricing methodology and revenue cap determinations for each TNSP will be progressed concurrently. Notwithstanding the comments set out in section 6, ETNOF also notes that in the case of the TNSPs whose revenue cap reviews are to be commenced in the next two years, there is a need for transitional provisions to be developed in recognition of the possibility that the Pricing Methodology Guidelines may not be in place before those TNSPs must submit their proposed pricing methodologies for approval under the new Rule. These transitional provisions may provide for the creation of interim Pricing Methodology Guidelines, or for the limited extension of the pricing methodologies presently applied by the relevant TNSPs.

Apart from these matters, ETNOF is not aware at this time of any other matter in addition to those described in Clause 6A.33 that need be the subject of saving or transitional provisions.

7.3 TUOS rebates to embedded generators

Issues relating to TUOS rebates were discussed at length during the transmission pricing review conducted by NECA and the ACCC. A pragmatic arrangement was adopted by the ACCC, under which embedded generators receive avoided TUOS in recognition that they defer transmission investment in general, rather than considering the value of avoided network costs on a specific case-by-case basis. It was recognised by the ACCC at the time that under such arrangements, some embedded generators would be over-compensated

while others would be under-compensated, but on balance, the avoided TUOS regime is an administratively simple way to compensate embedded generators for the general deferral of transmission investment.

ETNOF broadly supports all three options outlined in the Rule Proposal Report. In particular:

- ETNOF strongly supports the proposition that any network support payments made to an embedded generator should be adjusted to reflect the expected TUOS rebates that the generator will receive, to ensure that there is no “double dipping”.
- ETNOF also sees merit in the proposition that TUOS rebates should only apply to generators up to an appropriately defined capacity threshold, while beyond that threshold generators would remain eligible for network support payments. In addition to the suggestion of a 10 MW threshold, there would be merit in considering whether a threshold of 30 MW (which corresponds to the present definition of “scheduled generator”) would be appropriate.

7.4 Interregional TUOS

The Rule Proposal Report noted that most of the submissions received on this issue were in favour of minimal change only or for guidance to be sought from the MCE. The Commission has sought further submissions on other potential approaches for the treatment of inter-regional TUOS, but it has made no specific proposals at this time. Page 91 of the Rule Proposal Report states:

“Recognising the inter-jurisdictional nature of this issue and the views of submitters that the MCE should be consulted, the Commission proposes to consult with the MCE regarding its view on the options for addressing this matter.”

ETNOF reaffirms its view that this is indeed a matter on which MCE guidance should be obtained. ETNOF looks forward to reviewing and commenting on any draft Rules that address this matter.