

24 June 2010

Mr John Pierce  
Chairman  
Australian Energy Market Commission  
Level 5, 201 Elizabeth Street  
Sydney NSW 2000

Via website: [www.aemc.gov.au](http://www.aemc.gov.au)

Dear John,

### **Inter-regional Transmission Charging Rule Change Proposal**

Grid Australia makes this submission in response to the Australian Energy Market Commission (AEMC) Inter-regional Transmission Charging Rule Change consultation.

Consistent with its previous submissions, Grid Australia supports the implementation of a load export charge based on the locational component of prescribed transmission prices to commence from 1 July 2012 at the earliest.

Grid Australia considers that the key issues requiring resolution prior to the introduction of the draft rule change are as follows:

- The current proposal, which includes the postage stamped components of prescribed transmission prices, is likely to result in importing regions making a contribution significantly beyond the long run marginal costs of existing and new transmission assets which support inter-regional flows. The inclusion of postage stamped components in the load export charge departs significantly from the principles under which the current pricing regime was established.
- In order to allow capacity based locational (and postage stamped if required) charges to be applied a rule provision defining the directional capacity of the interconnectors is required.
- The significantly higher level of change in the draft rule, beyond that previously proposed, requires over-arching transitional provisions allowing TNSPs to amend their pricing methodologies to the extent necessary to ensure they are able to be compliant with both their methodologies and the amended Rules.
- Adoption of 1 July 2012 as the earliest prudent commencement date due to the requirement to amend TNSP pricing methodologies and other factors discussed in the attachment.

Grid Australia looks forward to working with the AEMC and stakeholders in further developing the Rule change proposal. If you require any further information, please do not hesitate to contact me on (08) 8404 7983.

Yours sincerely,



Rainer Korte  
**Chairman**  
**Grid Australia Regulatory Managers Group**

# Inter-regional Transmission Charging Rule Change Proposal

Response to AEMC Consultation Paper

24 June 2010

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## 1. Background

Grid Australia makes this submission in response to the AEMC's Inter-regional Transmission Charging Rule Change consultation.

Grid Australia and its members have participated in the development of the NEM transmission pricing arrangements since their inception and Grid Australia has actively engaged with the AEMC and policy makers to ensure that the proposed inter-regional transmission charging regime is able to be practically implemented.

## 2. Introduction

Consistent with its previous submissions, Grid Australia supports the implementation of a load export charge based on the locational component of prescribed transmission prices to commence from 1 July 2012 at the earliest.

While all items in the AEMC's consultation paper have been addressed in the body of this response, Grid Australia considers that the key issues requiring resolution prior to the introduction of the draft rule change are as follows:

- The current proposal, which includes the postage stamped components of prescribed transmission prices, is likely to result in importing regions making a contribution significantly beyond the long run marginal costs of existing and new transmission assets which support inter-regional flows. The inclusion of postage stamped components in the load export charge departs significantly from the principles under which the current pricing regime was established. To depart from these economic efficiency principles is inconsistent with the National Electricity Objective and, thus, a policy issue which should not be introduced at this stage of the consultation process.
- In order to allow capacity based locational (and postage stamped if required) charges to be applied a rule provision defining the directional capacity of the interconnectors is required.
- The significantly higher level of change in the draft rule, beyond that previously proposed, requires over-arching transitional provisions allowing TNSPs to amend their pricing methodologies to the extent necessary to ensure they are able to be compliant with both their methodologies and the amended Rules.
- Adoption of 1 July 2012 as the earliest prudent commencement date due to:
  - the requirement to amend TNSP pricing methodologies,

- Powerlink will have become fully subject to chapter 6A of the Rules by that time; and
- CNSPs will be required to commence the calculation of the charge for adjoining CNSPs as early as January 2011 to meet the AEMC's currently proposed commencement date.

Grid Australia would welcome the opportunity to work with the AEMC on specific aspects of the draft Rule in the lead up to the draft determination.

### 3. Issues for Consultation

#### 3.1 What should be the composition of a load export charge?

*1.1 As a charge is proposed to be calculated for an export load in the same way as other loads, how should the export load be defined? That is, should an export load be defined as a notional interconnector that joins two regions or should individual connection points be recognised? How does the definition of the export load impact on the calculation of the load export charge and the redistribution of settlement residue amounts as discussed in the following sections of this paper?*

*How should the export load be defined?*

The charge attributable to each notional interconnector will be the sum of the charges attributable to a connection point or a group of connection points. To convert this to a price and ultimately back into a periodic charge a capacity (load) is required.

As the capacity of the notional interconnector is more readily and meaningfully defined than that of the individual interconnectors which make it up, this is the appropriate quantity to use.

A prescribed capacity is required for three major reasons:

- In order to charge the locational (and if required TUOS non-locational and common service) component(s) based on capacity, a contracted demand must be defined. In the absence of connection agreements which specify such a quantity a rule provision defining the quantity which applies in its place is required. This is an ongoing requirement not a transitional one.
- In order to guarantee full recovery of the charge a capacity which remains fixed during the financial year is necessary.
- In order to ensure consistency in how the load export charge is calculated between regions.

The definition of notional interconnector capacity will significantly impact the magnitude of the TUOS non-locational and common service component charges.

Two options are readily available:

- The capacity used by AEMO in the settlements residue auction process.
- The maximum directional flow in the notional interconnector in the previous financial year.

The former has the advantage of year on year stability but does not provide a capacity for Basslink as Basslink is not subject to the settlements residue regime. The basic design limits for transfers across Basslink are, however, published by AEMO in its “*Interconnector Quarterly Performance Report*”. The latter is readily quantifiable but subject to significant variance year on year which may result in significant price volatility.

*How does the definition of the export load impact on the calculation of the load export charge and the redistribution of settlement residue amounts as discussed in the following sections of this paper?*

In order to prevent the interplay of the redistribution of residues via TUOS locational charges and the calculation of the load export charge, the draft Rule has changed the basis for their redistribution. The draft Rule mandates that all residues be redistributed via the adjusted TUOS non-locational charge. The definition of the export load does not appear to impact on their redistribution.

1.2 *Do the existing provisions under the Rules provide for cost-reflective price signals in relation to the use of the transmission network by a region that imports electricity from an adjoining region? Do customers in an importing region use the exporting TNSP's services in a similar way to customers within the region?*

*Do the existing provisions under the Rules provide for cost-reflective price signals in relation to the use of the transmission network by a region that imports electricity from an adjoining region?*

The existing Rules do not provide for cost-reflective price signals in relation to the use of the transmission network by a region that imports electricity from an adjoining region. However, in calculating cost-reflective prices for customers, the interconnections with adjacent jurisdictions must be modelled to allow locational charges to be identified and, in the absence of inter regional charging, recovered from customers via TUOS non-locational charges.

*Do customers in an importing region use the exporting TNSP's services in a similar way to customers within the region?*

In simplistic terms customers in importing regions use the shared network services of the exporting region in a similar way to customers within the region that being the conveyance of electricity from generators to loads.

The principal point of difference is that within the exporting region customers, particularly prospective customers, have some ability to understand and respond to locational pricing signals. It is not clear that customers in the importing region would be readily able to associate their behaviour with the load export charge allocated to them and respond appropriately. This would depend, in part, on the relative materiality of the inter-regional charge.

1.3 *What should be the composition of the load export charge that would reflect the use of the transmission network by customers in the importing region? If the charge should include charges for prescribed TUOS services, should both the locational and non-locational component be included?*

Grid Australia believes that the current proposal, which includes the postage stamped components of prescribed transmission prices, is likely to result in importing regions making a contribution significantly beyond the long run marginal costs of existing and new transmission assets which support inter-regional flows.

Further, to include postage stamped components would be to impose costs on customers of an adjoining region that bear no relation to their proportionate use of the adjoining region's transmission system assets. Such a view is also consistent with the ACCC position (below) where it was expressed that rather than to be used as a tool for economic signalling, the non-locational component is too serve as a recovery mechanism that will cause the least distortion possible:

*“In its final authorisation decision on NECA’s proposed Code changes in 2001, the ACCC considered that TUOS General charges (being the former equivalent charge) should not automatically be recovered from inter-regional customers. This was because these charges were not intended to fulfil an economic signalling function but to recover the remainder of a TNSP’s regulated revenue. Therefore, the ACCC considered that TUOS General charges should be uniform over as wide an area as possible to avoid distorting participants’ consumption, production and investment decisions. The ACCC considered that levying the non-locational component of TUOS services charges on importing TNSPs was not certain to increase the overall degree of uniformity of these charges across the NEM and hence should not be imposed on inter-regional flows.”<sup>1</sup>*

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<sup>1</sup> Frontier Economics(2008) ‘Advice on the application of AEMC options for an inter-regional mechanism in the NEM April 2008’

The inclusion of postage stamped components in the load export charge departs significantly from the principles under which the current pricing regime was established. These principles reflect the economic efficiency principles embodied in the National Electricity Objective. Therefore, to depart from these principles is a policy issue which should not be introduced at this stage of the consultation process. As far as Grid Australia is aware there are no existing policy principles which would permit the AEMC to depart from the requirements of the National Electricity Objective in relation to this matter.

### 3.2 How should a load export charge be calculated?

*2.1 Is the proposed load export charge consistent with the current pricing principles under the Rules?*

By treating the point(s) of connection of a notional interconnector as a connection point the prices and charges can be calculated in a manner broadly consistent with the principles.

The change to prevent the locational return of settlements residue auction proceeds to customers in the exporting region is a material departure from the principles. In addition there are a number of divergences which would make the application of the Rule change at odds with approved TNSP pricing methodologies.

Grid Australia believes a broader range of transitional provisions are required to allow CNSPs to modify their approved pricing methodologies to the extent required to implement the changes arising from this Rule change. This would eliminate the double jeopardy inherent in the requirement to be compliant with both the Rules and the approved pricing methodology.

*2.2 What are the differences in the current pricing methodologies adopted by TNSPs and how would any differences need to be addressed? Given that, under the proposed Rule, TNSPs would levy charges on each other, what would be the impact of differences in pricing methodologies of those charges?*

The most material difference between the pricing methodologies of the TNSP's is implementation of cost reflective network pricing (CRNP) in the Victorian region, Specifically the use of 10 peak days and the energy method of calculation versus 365 days and the capacity method used by all other regions. The draft Rule change correctly identifies this as a fundamental issue that must be addressed.

ElectraNet and Transend use approved implementations of the modified cost reflective network pricing methodology. This was adopted in order to send appropriate economic signals to customers on lightly loaded, typically radial, lines. It has no material impact on the proposed load export charge.

The pricing methodology guideline mandates that the contract agreed maximum demand should only be used for charging if the customer's connection agreement or other enforceable instrument governing the terms of connection stipulates a fixed maximum demand and penalties for exceeding that demand. Consideration should be given to the ability to satisfy this requirement under the proposed arrangements.

2.3 *What level of discretion should be given to TNSPs in calculating charges? Should any specific provisions be made to account for potential differences in pricing methodologies?*

As noted elsewhere in this submission Grid Australia believes it is appropriate to have a general transitional provision allowing them to modify their approved pricing methodologies to the extent required to implement the changes arising from this Rule change. As with the AEMO specific transitional provision it may be appropriate to have the AER approve these proposed changes.

2.4 *How prescriptive should the pricing requirements for a load export charge be? For example, should the Rules specify the types of assets to be included? Should the calculations for the load export charge be based on gross or net interconnector flows?*

Grid Australia believes that the Rules should not be overly prescriptive in the calculation of the load export charge. Given the extremely complex nature of prescribed transmission pricing to introduce additional complexity in the Rules runs the real risk of unintended consequences arising. Grid Australia considers it would be more appropriate for the more detailed implementation issues to be dealt with in changes to TNSP pricing methodologies, which would be subject of approval by the AER.

With respect to prescription of the assets involved as noted in the Consultation Paper<sup>2</sup>

*“The proposed Rule is aimed at achieving a load export charge which reflects the costs of all (new and existing) assets that contribute to export flows to the adjoining regions as if an adjoining region was a load on the region boundary.”*

Implicit in this is that the population of shared assets used for the calculation of the charge is the same as that used for the calculation of the customer charges. Any deviation from this would substantially change the nature of the charge and be inconsistent with the cost reflective network pricing methodology.

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<sup>2</sup> Page 8, AEMC Interregional transmission charging, consultation Paper 13 May 2010

A related matter is that in order for the cost reflective network pricing (CRNP) process to operate the energy flows in both directions on the interconnector(s) must be modelled rather than setting the flows to zero when it is importing. This is consistent with the way interconnectors are currently modelled for prescribed pricing.

Conversely, when calculating postage stamped prices and charges only the half hourly load (export) component of the energy flow should be considered as otherwise it is possible to have negative charges in some months. This does not appear consistent with the intent of the proposed rule.

This matter needs to be carefully considered in the formulation of the draft Rule.

### 3.3 How should a load export charge be recovered by the importing TNSP?

*3.1 On the basis that the load export charge should promote more cost reflective price signals, what should be taken into consideration in determining how the load export charge should be recovered?*

The draft Rule specifies a methodology which successfully insulates the recovery of the charge from the calculation of the charge to the adjacent region.

There is no available methodology which would allow the export charge from the adjacent region to be passed through to customers using the cost reflective network pricing methodology which would not in turn influence the export charge to the adjoining region.

Accordingly an alternative methodology is required. The most administratively efficient mechanism would be to prorate the charge to customers on the basis their expected annual charge for that component of their prescribed transmission charges.

*3.2 How should any auction proceeds be distributed to customers in an importing region?*

The draft Rule mandates the distribution of auction proceeds to customers via the TUOS non-locational component.

An alternative would be to include it as an adjustment to the prescribed TUOS services - pre-adjusted locational component – customer connection points. This would then result in it being allocated in a manner closer to the proportional use of the assets.

### 3.4 Would introducing a load export charge impact MNSPs?

4.1 *How does the proposed load export charge impact on customers in regions that import electricity from a region interconnected by an unregulated interconnector? What, if any, specific provisions should be considered as a part of this Rule change process?*

Grid Australia sees no difference in principle between interconnection via a regulated interconnector versus an MNSP. As is appropriate in the latter case the cost of the interconnector is not reflected but that of the supporting network is. This would appear consistent with the objectives of the export charge.

### 3.5 What factors need to be considered for administrative efficiency?

5.1 *What are the administrative impacts on CNSPs by introducing new type of payments between CNSPs? For example, how often should payments be made? Should the payments be made on a gross or net basis? Would TNSPs be exposed to a new credit risk and, if so, how should the risk be managed?*

Grid Australia does not see material administrative issues with the payments between CNSPs once the regime is established.

Specifying gross payments on a monthly basis with provision for other arrangements to be agreed between the parties would be reasonable. In the absence of a connection agreement or other enforceable instrument between adjoining CNSPs it would be appropriate to specify default conditions or require terms to be agreed between the parties.

There does not appear to be a material increase in prudential risk to be managed.

### 3.6 What would be the appropriate level of prescription and transparency for any new pricing provisions?

6.1 *Are there other factors relating to the level of prescription and transparency that have not already been considered under the other questions raised? For example, should payment terms and the billing period be specified for payments between CNSPs?*

As noted above the specification of default payment terms with the option for agreement to alternative arrangements between the parties may be of benefit.

With this exception Grid Australia does not believe that additional prescription is warranted.

6.2 *In regions where there are multiple TNSPs, does the way in which a CNSP bill and receive payments from TNSPs within that region need clarification and/or prescription?*

Grid Australia does not believe that additional prescription is required.

6.3 *Should a load export charge be able to be implemented without the requirement for the AER to produce new pricing methodology guidelines? If so, would any clarifications need to be included in the new Rules?*

It would be appropriate for the AER to amend the pricing methodology guidelines to take into account the impacts of this Rule change process for proposed pricing methodologies submitted as part of future revenue applications.

Grid Australia believes it is appropriate to have a general transitional provision allowing them to modify their approved pricing methodologies to the extent required to implement the changes arising from this Rule change. As with the AEMO specific transitional provision it would be appropriate to have the AER approve these proposed changes.

It would not be necessary for the guideline to be amended in order for the AER to assess the changes required to the pricing methodologies within the revenue control period.

### **3.7 What transitional provisions should be considered to ensure stability and regulatory certainty?**

7.1 *Implementing a load export charge would likely result in the one-off redistribution of transmission service charges. This redistribution may impact some customers more than others. Should any specific provisions be put in place to manage the potential change in charges?*

Subject to the outcomes of modelling to be conducted by Grid Australia and AEMO the need for transitional provisions to manage the ongoing redistribution of charges between the regions remains unclear. However, the volatility of annual energy flows across interconnectors would lead to considerable volatility in the load export charge on a year to year basis. The effect of this volatility on customers (in both the importing and exporting regions) would depend on the relative materiality of the charge.

Grid Australia is concerned that the introduction of the postage stamp components to the load export charge will materially increase the impact of the load export charge on customers and may lead to even greater volatility from year to year.

7.2 Would it be feasible to implement the proposed load export charge by 1 July 2011? What factors should be taken into consideration to determine the implementation date? What transitional provisions would need to be in place to allow any new provisions to be implemented as soon as practicable while ensuring that regulatory certainty is maintained?

Consistent with previous submissions Grid Australia strongly supports the adoption of 1 July 2012 as the earliest prudent commencement date. This is due to:

- the requirement to amend pricing methodologies,
- that Powerlink will be subject to chapter 6A of the Rules at that time and
- that the CNSPs will be required to commence the calculation of the charge for adjoining CNSPs as early as January 2011 to meet the AEMC's proposed commencement date.