

Cost Allocation Arrangements for Transmission Services

Response to NGF Rule Change Proposal

2 May 2008

Grid Australia's response to the NGF's Rule change proposal

1. Introduction

- 1.1 Grid Australia welcomes the opportunity to comment on the Rule change proposal submitted by the National Generators' Forum (NGF) in respect of transmission entry and exit charges. This submission is Grid Australia's response to the NGF Rule change proposal.
- 1.2 The NGF's Rule change proposal is to¹:
- (a) amend the grandfathering provisions in clause 11.6.11 so that only *entry services* or *exit services* provided by a 'grandfathered' asset as at 16 November 2006 are treated as *prescribed entry services* or *prescribed exit services*;
 - (b) preserve the cost allocation methodology in respect of grandfathered *entry services* or *exit services* that applied immediately prior to the commencement of new Chapter 6A of the Rules, while ensuring that TNSPs suffer no revenue shortfall as a result;
 - (c) ensure that an asset cannot be removed from the RAB as a result of a reconfiguration of the *transmission system* unless the relevant *Network User* or group of *Network Users* agree to its removal; and
 - (d) clarify that the *Transmission Ring-Fencing Guidelines* do not apply to cost allocation between regulated *transmission services*.
- 1.3 The NGF explains that in its view the current Rules can lead to the inefficient shifting of costs from *shared transmission services*, to *entry services* or *exit services* as a result of a re-allocation of costs or a *network* reconfiguration undertaken for the benefit of *Network Users* generally. The NGF further comments² that by addressing this concern its proposed Rule change will increase efficiency in the National Electricity Market (NEM) by:
- (a) removing the potential for price shocks to arise due to the shifting of costs; and
 - (b) increasing regulatory certainty.
- 1.4 As a matter of principle, Grid Australia supports measures that increase regulatory certainty and reduce the scope for uneconomic price shocks. As such, Grid Australia supports the broader objectives described by the NGF in its Rule change proposal. Grid Australia is, however, concerned that the NGF's Rule change proposal does not go far enough with respect to the shortcomings of the current grandfathering provisions. In particular, Grid Australia considers that further amendments to clause 11.6.11 are required to ensure that the grandfathering arrangements can operate in a practical and effective way.
- 1.5 This submission addresses each of the NGF's proposed Rule changes in turn.

¹ National Generators' Forum Proposed Rule Change, page 1.

² National Generators' Forum, Addendum to Proposal for Rule on Transmission Entry and Exit Charges, page 1.

2. Clarifying the grandfathering provisions in clause 11.6.11

Overview of the NGF's proposed Rule change

- 2.1 The NGF comments that its proposed amendments to clause 11.6.11 are intended to clarify what the NGF understands to have been the intent of the existing clause 11.6.11. The NGF explains that its proposed drafting³:
- (a) introduces separate definitions of 'eligible existing assets' and 'eligible committed assets' (paragraph (aa));
 - (b) provides that, while the relevant transmission assets themselves must have been in use or committed as at 9 February 2006, the services to be grandfathered are those which were being provided when the first of the 2006 Economic Regulation Rules came into effect (16 November 2006) (paragraph (a)(4));
 - (c) recognises that an asset that was committed to be constructed as at 9 February 2006 might not actually have been providing grandfathered services by 16 November 2006, and so explicitly grandfathers the services that will be provided by that asset when it comes into operation (paragraph (a)(1)(ii));
 - (d) recognises that, for so long as the value of an 'eligible existing asset' or 'eligible committed asset' is included in the RAB (whether or not under a pre-existing revenue determination) a connection service provided by that asset should continue to be treated as a grandfathered service (paragraph (a)(2)); and
 - (e) recognises that, for so long as the price for the service is not negotiated, a *connection service* provided by a qualifying asset should continue to be treated as a grandfathered service (paragraph (a)(3)).
- 2.2 For completeness, it is noted that the NGF's Rule change proposal for clause 11.6.11 also:
- (a) limits the costs of assets that may be allocated to *prescribed entry services* or *prescribed exit services* to the costs of those assets which were fully dedicated to the provision of those services at the relevant connection point as at 16 November 2006 (paragraph (d)); and
 - (b) ensures that no residual portion of the *AARR* is left unallocated as a result of the application of the proposed grandfathering provisions (paragraph (e)).

These aspects of the NGF's Rule change proposal are addressed in section 3 of this submission.

- 2.3 The NGF then explains why it believes that the regulatory Rule review which led to the enactment of Chapter 6A creates the possibility of price shocks⁴. In particular, the NGF comments that whilst a grandfathering provision was introduced, ambiguity

³ National Generators' Forum Proposed Rule, Appendix 2 Explanation of Clauses for Draft Rule, page 2

⁴ National Generators' Forum, Addendum to Proposal for Rule on Transmission Entry and Exit Charges, pages 1 and 2.

remains over whether costs from shared (*shared transmission service*) assets that existed prior to 9 February 2006 can now be shifted to generator connection (*entry service*) assets or customer connection (*exit service*) assets.

- 2.4 The NGF concludes by commenting that the Rule change proposal prevents the costs from historically shared (*shared transmission service*) assets being shifted to grandfathered *Network User* connection assets. As such, the NGF comments that the Rule change proposal removes the possibility of price shocks and hence promotes regulatory certainty.

Grid Australia's comments on the NGF's Rule change proposal

- 2.5 In broad terms, the NGF Rule change proposal points to a lack of clarity with existing clause 11.6.11, and suggests that there are a number of different ways in which that clause may be interpreted. Grid Australia strongly supports the NGF's view that the existing clause 11.6.11 is deficient and should be amended.
- 2.6 Grid Australia has identified the following concerns with the current clause 11.6.11:
- (a) confusion as to whether services or assets (or both) are grandfathered. The clause is drafted as if it is grandfathering services, although the AEMC's comments at the time of making the Rule could be read as suggesting an intention to grandfather assets;
 - (b) difficulty in reconciling the AEMC's comments (as set out in the 16 November 2006 Rule decision) with various other provisions of the Rules. For example, Rule 5.3 and the *negotiating framework* do not provide for the conversion of *prescribed transmission services* [assets] to *negotiated transmission services* [assets] at the initiation of the TNSP;
 - (c) there is no clear trigger as to:
 - (i) when a *prescribed entry service* or a *prescribed exit service* ceases to be grandfathered; and
 - (ii) what changes in the assets used to provide a grandfathered connection service trigger a change in status of the service or part of the service. Questions therefore arise as to whether any part of the service remains grandfathered after the relevant change in the assets;
 - (d) it is not clear whether an existing *connection service* provided as at 16 November 2006 remains grandfathered when there is a later change in the quantity of the service being provided (e.g. an increased level of agreed maximum demand) but no change to the assets being used to provide the service; and
 - (e) difficulty in reconciling the principle that grandfathered services or assets may change from *prescribed transmission services* to *negotiated transmission services* with the *Cost Allocation Principle* that costs which have been allocated to *prescribed transmission services* must not be reallocated to *negotiated transmission services*.

- 2.7 Grid Australia supports a re-draft of clause 11.6.11 to address the above concerns. Grid Australia concurs with the NGF that as presently drafted clause 11.6.11 creates uncertainty, and therefore an amended provision would further the achievement of the National Electricity Objective.
- 2.8 A particular concern identified by Grid Australia is that clause 11.6.11 is not clear in the way that it applies to the replacement of assets that were previously used to provide grandfathered *connection services*. Following discussions with Grid Australia the AER has also concluded that clause 11.6.11 is unclear and could be open to different interpretations. Importantly, the AER has now concluded that it is currently obliged to interpret clause 11.6.11 as requiring any replacement of a grandfathered asset to be treated as a *negotiated transmission service* and therefore to be remunerated outside the TNSP's revenue cap.
- 2.9 In light of the AER's interpretation of clause 11.6.11, Grid Australia is concerned that significant practical issues will arise for TNSPs and *Network Users* if this interpretation is applied. In particular, the practical implications of AER's interpretation include:
- (a) *Network Users* will be required to engage in negotiation with TNSPs for *entry services* and *exit services* as assets technically transition from *prescribed transmission services* to *negotiated transmission services*. These negotiations will be required even if neither party wishes to change the existing service or the charges for the existing service.
 - (b) The existing Rules relating to a TNSP's *negotiating framework* are predicated on the reasonable presumption that the *Network User* is seeking a service from the TNSP⁵. However, if negotiation is required as a result of an asset replacement, it is the TNSP that will be approaching the *Network User* in order to provide "new" *negotiated transmission services*. Not surprisingly, the TNSPs' existing *negotiating frameworks* do not contemplate this situation.
 - (c) *Network Users* and TNSPs may be required to engage in multiple renegotiations in respect of the same *entry service* or *exit service* as *connection assets* are replaced over time.

It is self-evident that the practical issues arising from the AER's interpretation of clause 11.6.11 should be addressed by amending this provision.

- 2.10 At this stage, however, the NGF's Rule change proposal is focused on other potential difficulties with clause 11.6.11. The NGF's Rule change proposal explains its particular concerns regarding clause 11.6.11 in the following terms⁶:

"The current lack of clarity in clause 11.6.11 can be shown by the example of an historically shared network asset which, following a reconfiguration undertaken for the benefit of the shared network, now provides dedicated connection services (as illustrated in diagram 2 below). There are two possible interpretations of clause 11.6.11 in this situation:

⁵ For example, see clause 6A.9.5(a).

⁶ National Generators' Forum Proposed Rule Change, pages 5 and 6.

- Connection services provided by that asset at any point in time are grandfathered, so that if the nature of the services provided by that asset subsequently changes from shared network to dedicated entry services, those entry services will be prescribed transmission services; or
- The clause only grandfathers the services being provided by that asset at a particular point in time. In a situation where the reconfigured asset provides a different service, that “new” service is therefore not grandfathered and, being a connection service, is therefore classified as a negotiated transmission service.

The NGF considers that the second interpretation is correct, since it is consistent with the apparent intent of clause 11.6.11 and with the underlying purpose of grandfathering, which is to ensure that matters treated in a particular way before a regulatory change continue to be treated in the same way after that change. Under this interpretation, a subsequent change in the use of an asset cannot result in new prescribed entry or exit services being provided by that asset. “New” services will be negotiated transmission services and so cannot be the subject of a reallocation of costs which have previously been allocated to prescribed shared transmission services. The possibility of alternative interpretations introduces unnecessary ambiguity and uncertainty as to the application of clause 11.6.11, and consequently as to the treatment of connection services in terms of cost allocation. The following discussion of cost allocation issues assumes that clause 11.6.11 has been clarified to reflect the preferred (second) interpretation.”

- 2.11 Grid Australia understands the NGF’s view that the grandfathering provisions should ensure that assets previously classified as *shared transmission services* assets should not be capable of being reclassified as *entry services* or *exit services* assets. However, it is also clear that the NGF’s focus on grandfathering assets (rather than services) will not address the practical shortcomings noted above that arise from the existing clause 11.6.11. In particular, the NGF’s proposed grandfathering of assets will mean that the grandfathering provisions cease to apply as assets are replaced, with the consequence that any new assets (even minor replacements) will be treated as providing a *negotiated transmission service* and not a *prescribed entry service* or a *prescribed exit service*. This will require multiple, successive negotiation as assets are progressively replaced through the life of the connection service, and will add to the overall costs to the industry with no discernible benefit to consumers. Grid Australia considers that such an outcome is contrary to common sense and is inconsistent with the National Electricity Objective.
- 2.12 In light of the above comments, Grid Australia considers that the NGF’s Rule change proposal for clause 11.6.11 in its current form would leave important difficulties unresolved. Specifically, whilst Grid Australia supports the NGF’s intention to clarify the meaning of clause 11.6.11 and to preserve the cost allocation arrangements for *entry services* and *exit services* which existed prior to the commencement of the new Rules, the proposed changes will not deliver workable, practical outcomes for *Network Users* or TNSPs.
- 2.13 Grid Australia considers that there is a clear and practical need for the AEMC to examine clause 11.6.11 more broadly in light of the NGF Rule change proposal and Grid Australia’s submission. However, if the AEMC concludes that it can not examine these broader issues when considering the NGF Rule change proposal, Grid Australia would need to consider lodging its own Rule change proposal to address the practical shortcomings arising from clause 11.6.11. Grid Australia recognises that any such Rule change proposal should ideally be submitted in June in order to give the

AEMC sufficient time to consider that proposal prior to the scheduled publication date for its draft Rule determination of 11 July 2008.

3. Preservation of cost allocation arrangements for grandfathered services

Overview of the NGF's proposed Rule change

3.1 As noted in section 2 above, the NGF's Rule change proposal for clause 11.6.11 also:

- (a) limits the costs of assets that may be allocated to *prescribed entry services* or *prescribed exit services* to the costs of those assets which were fully dedicated to the provision of those services at the relevant connection point as at 16 November 2006 (paragraph (d)); and
- (b) ensures that no residual portion of the AARR is left unallocated as a result of the application of the proposed grandfathering provisions (paragraph (e)).

Grid Australia does not wish to comment on the latter proposition, other than to note that it is consistent with the clause 6A.23.2(c)(i) which states that every portion of the AARR should be allocated to *prescribed transmission services*.

3.2 In respect of cost allocation, the NGF has identified two sources of concern:

- (a) *network* reconfigurations that may result in moving asset boundaries and shifting '*shared transmission service costs*' to *entry services* and *exit services*; and
- (b) '*shared*' *network* costs migrating to *entry services* and *exit services* over time.

3.3 The NGF explains that its proposal for limiting the cost allocation arrangements will have the following effects⁷:

"This maintains the initial cost allocation position under the old Part C and schedule 6.2 of old Chapter 6 in that only fully dedicated assets could be classified as entry assets for which the costs were recoverable through entry service charges. In this way, the proposed Rule will ensure that a generator's attributable cost share can not in future contain costs relating to assets that previously were considered to be providing prescribed TUOS services and hence were shared between Transmission Customers, as a consequence of developments on the network not triggered by the generator."

Grid Australia's comments on the NGF's proposed Rule change

3.4 The solution proposed by the NGF (of limiting costs which may be allocated to grandfathered connection services to those of assets fully dedicated to providing the *connection service* at a specific date) is not the only or preferred way of dealing with the issue of potential cost migration over time.

3.5 Grid Australia notes that another way of dealing with the issue identified by the NGF is (as Flinders Power proposed in 2007) to amend the pricing principles to provide that costs which have been allocated to 'shared' categories of *prescribed transmission services* must not be reallocated to *prescribed entry services* or *prescribed exit services*.

⁷ National Generators' Forum Proposed Rule Change, pages 3 and 4.

- 3.6 Grid Australia notes that clause 6A.19.2(7) (which sets out the *Cost Allocation Principles*) states that:
- “costs which have been allocated to *prescribed transmission services* must not be reallocated to *negotiated transmission services*.”
- 3.7 Grid Australia’s view is that clause 6A.19.2(7) was originally intended to address the type of cost allocation issue raised by the NGF (i.e. that costs which have been allocated to *shared transmission services* must not be reallocated to *entry services* or *exit services*). Unfortunately, the *Cost Allocation Principle* in clause 6A.19.2(7) does not apply to the allocation of costs between *shared transmission services* and *prescribed entry services* or *prescribed exit services* under Part J of the Rules. Unlike negotiated *entry services* or *exit services* it is possible under Part J of the current Rules that *shared transmission services* costs could be reallocated to grandfathered *entry services* or *exit services* (as the latter are *prescribed transmission services*).
- 3.8 Grid Australia therefore supports the NGF’s view that drafting changes are required to protect *Network Users* from any unintended reallocation of costs from *shared transmission services* to grandfathered *entry services* or *exit services*.
- 3.9 Grid Australia questions, however, whether the changes proposed by the NGF provide the best means of effecting this change. In particular, Grid Australia is concerned that the drafting changes proposed by the NGF may raise practical difficulties in their application. This is a matter for the AEMC to consider during its second consultation phase.

4. Limited removal of assets from the RAB

Overview of the NGF’s proposed Rule change

- 4.1 The NGF proposed to introduce a new paragraph (ab) to clause S6A.2.3, which prevents the removal of the value of an asset from the RAB during a regulatory reset in circumstances where:
- (a) there has been a reconfiguration of the *transmission system*; and
 - (b) that reconfiguration causes relevant conditions for removal of an asset from the RAB in clause S6A.2.3(a) to be met; and
 - (c) the affected *Transmission Network User(s)* have not requested or consented to the reconfiguration or have not unreasonably refused or failed to consent to the removal of the asset from the RAB.
- 4.2 The NGF’s proposal also states that a *Network User's* refusal or failure to consent to the removal of an asset from the RAB cannot be unreasonable if the removal of the value of the asset from the RAB (and the consequent application of the TNSP’s *Negotiated Transmission Service Criteria*) would be likely to result in an increase in service charges for that *Network User* that is greater than 5%. The NGF explains that this threshold is proposed as it is generally accepted for accounting purposes to represent a material impact.

4.3 The NGF explains its rationale for the proposed Rule change in the following terms⁸:

“The Cost Allocation Principles in the Rules prevent the reallocation of costs from prescribed to negotiated transmission services. The NGF supports this principle. However, it is still possible for such a reallocation to occur under the current Rules if assets are removed from the RAB by the AER on a regulatory reset, following a unilateral reconfiguration of the transmission system by the TNSP. This result would be inconsistent with the principles adopted by the AEMC in formulating the 2006 Economic Regulation Rules. The issue of reconfiguration of assets is a fairly recent one and is likely to be on the increase due to the aging nature of much of the network. The potential unintended operation and effects of clause S6A.2.3 of the Rules is described below.

A network user can be affected by a reconfiguration of the transmission system without having requested or otherwise given consent to the change. The service provided to the user may not change. Indeed, in the case of a generator, the reconfiguration may result in reduced service. However, if an asset that previously provided shared transmission services becomes a dedicated connection asset, the AER would have the discretion under clause S6A.2.3 to remove the value of that asset from the RAB (provided all other conditions for removal are also met). Once the asset value is removed from the RAB, the service provided by that asset would only be characterised as a negotiated service, leaving the network user liable to the full cost of the asset. This outcome appears contrary to the Cost Allocation Principles in the Rules.”

Grid Australia’s comments on the NGF’s proposed Rule change

4.4 Grid Australia recognises and accepts the NGF’s concerns in relation to the potential reallocation of costs from *shared transmission services* to *entry services* or *exit services* as a result of a *network* reconfiguration. Grid Australia considers that relatively simple drafting changes could be introduced to provide *Network Users* with greater comfort that, for example, the reconfiguration of networks, would not lead to an unexpected and unmanageable increase in *entry service* or *exit service* costs. Grid Australia therefore broadly supports the NGF’s objectives provided it is also recognised that TNSPs must be able to recover these types of costs.

4.5 Grid Australia shares the NGF’s concern that the Rules could result in “new” *negotiated transmission services* being provided by the TNSP to a *Network User* as a result of a *network* reconfiguration, even though the actual service provided by the TNSP does not change and the *Network User* did not request a change in service. From Grid Australia’s perspective, the Rules should be clear that:

- (a) *negotiated transmission services* are services requested by the *Network User* and negotiated in accordance with the TNSP’s *negotiating framework*; and
- (b) TNSPs are able to recover these types of *network* reconfiguration costs via charges for *prescribed transmission services*.

4.6 Although Grid Australia recognises the NGF’s concerns, Grid Australia questions whether the proposed amendment of clause S6A.2.3 is the most appropriate or preferred Rule change or, moreover, whether it will achieve the desired objective. Whilst Grid Australia has no particular objections to the proposed Rule change, it may

⁸ National Generators’ Forum Proposed Rule Change, page 11.

be appropriate for the AEMC to consider carefully whether alternate drafting would better satisfy the National Electricity Objective.

5. Transmission Ring-Fencing Guidelines should not apply to cost allocation between regulated transmission services

Overview of the NGF's proposed Rule change

- 5.1 The NGF explains⁹ that in the course of reviewing the operation of the cost allocation principles, the NGF noted that one of the *Cost Allocation Principles* (in clause 6A.19.2(6)) indicates that the method of cost allocation for transmission services should be consistent with *Transmission Ring-Fencing Guidelines* issued by the AER. Similarly, the drafting of Rule 6A.21 does not clearly distinguish the functions of those Guidelines from the functions of the *Cost Allocation Principles*.
- 5.2 The NGF argues that the cost allocation between transmission services should be the exclusive province of the Rules through the *Cost Allocation Principles* rather than being dealt with in the *Transmission Ring-Fencing Guidelines*.

Grid Australia's comments on the NGF's proposed Rule change

- 5.3 Grid Australia agrees with the NGF's observations regarding ring fencing arrangements, and therefore supports the proposed Rule change.

6. Concluding comments

- 6.1 Grid Australia supports the broader objectives described by the NGF in its Rule change proposal. In particular, Grid Australia supports measures that increase regulatory certainty and reduce the scope for uneconomic price shocks.
- 6.2 Grid Australia welcomes and supports the NGF's conclusion that the grandfathering provisions in clause 11.6.11 are deficient and should be amended. This finding is further supported by the AER's view that clause 11.6.11 is unclear and is open to different interpretations. Grid Australia is very concerned that the AER's preferred interpretation of clause 11.6.11 will lead to substantial practical difficulties for *Network Users* and TNSPs.
- 6.3 Grid Australia considers that the NGF's Rule change proposal for clause 11.6.11 would leave the practical difficulties identified by Grid Australia unresolved. Grid Australia considers there is a clear and practical need for the AEMC to examine clause 11.6.11 more broadly in light of the NGF Rule change proposal and Grid Australia's submission. In this broader consideration of the grandfathering provisions, Grid Australia considers that the AEMC should have regard to the following principles:
- (a) The grandfathering provisions must provide reasonable certainty to *Network Users* regarding the scope of the grandfathered service.
 - (b) The grandfathering arrangements should properly address the practical issues arising from asset replacement;

⁹ National Generators' Forum Proposed Rule Change, page 12.

- (c) the scope of a *negotiated transmission service* should not be affected inadvertently by the cost allocation arrangements or the AER's assessment of the RAB; and
 - (d) the request to provide *negotiated transmission services* should be initiated by the *Network User*, not the TNSP.
- 6.4 Grid Australia recognises that the AEMC may conclude that it can only examine the proposal put to it by the NGF. In these circumstances, Grid Australia would lodge its own Rule change proposal to address the practical shortcomings arising from clause 11.6.11. Grid Australia will discuss this process issue with the AEMC in due course.
- 6.5 In addition to the outstanding issues arising from clause 11.6.11, Grid Australia has identified some potential concerns with other aspects of the NGF's Rule change proposal. Grid Australia's concerns primarily relate to the detail of the NGF's draft amendments, which in some instances may not be the preferred method of addressing the identified issues.
- 6.6 Grid Australia looks forward to working constructively with the AEMC, the NGF and other stakeholders in the next phases of the Rule change process.