

30 April 2008

Dr John Tamblyn
Chairman
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BY EMAIL: submissions@aemc.gov.au

Dear Dr Tamblyn

**REQUEST FOR A RULE CHANGE
COST ALLOCATION ARRANGEMENTS FOR TRANSMISSION SERVICES**

This submission has been written in response to the Rule Change Request initiated by the National Generator's Forum (NGF) relating to the treatment of shared network and connection charges in the National Electricity Rules (Rules). The EUAA does not support the proposed Rule changes. The EUAA considers that the NGF's arguments cannot be sustained against the efficiency objective enshrined in the National Electricity Objective. In summary, this submission:

- explains the NGF's proposed Rule change,
- examines the effect of the proposed Rule change on energy users,
- analyses the NGF's justification for its proposal, and
- concludes with a summary of why the EUAA considers that the AEMC should reject this proposal.

NGF's proposed Rule changes

The NGF is proposing Rule changes that will preserve ("grandfather") connection charging arrangements for all generators connected in the NEM at 16 November 2006, so that even if the network is reconfigured in future and assets that were once shared are now classified as providing services to specific generators, there will be no changes to charging arrangements for existing generators.

The configuration of the transmission network changes as the network develops. For example network elements (sub-stations or transmission lines) that were once dedicated to one generator can subsequently become shared with others. Radial transmission lines can become interconnected with other transmission infrastructure thus making them part of the shared infrastructure. This evolution can also result in assets that were once part of the shared network subsequently becoming dedicated to one or a few customers only.

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Under the existing Rules, connection charges would change if the transmission network is reconfigured so that assets that were previously classified as part of the shared network, were classified as connection assets. In this case, under the existing Rules, the costs of such assets following reconfiguration would be recovered through connection charges from individual generators, rather than through Transmission Use of System (TUoS) charges.

There are two aspects to the NGF's application:

- Firstly, the NGF argue for changing Clause 11.6.11 of the Rules so that if a network is reconfigured (and the result of this is to reclassify shared assets as connection assets), then generation entry costs should not be increased to recover the cost of such reclassified assets;
- Secondly, the NGF argue for changing Schedule 6A2.3 to the Rules so that generators have a veto over the Australian Energy Regulator's (AER's) right to remove assets from the Regulatory Asset Base (RAB) of affected transmission businesses, in the case that, following a network configuration, such assets now provide entry-only service, rather service to the shared network.

The NGF's application has cast this issue as one that was not properly appreciated at the time that the Rules were first drafted because, it asserts, at that time (1996) it was mistakenly believed that the transmission network was assumed to continue to expand, whereas now this may no longer be the case in particular locations.

The effect of the NGF's proposed Rule Change

The proposed Rule change is designed to ensure that generators connected to the transmission system at 16 November 2006 are insulated against increases in connection charges if the network is reconfigured. Existing generators are clearly the winners from this proposal. Since generators do not share in TUoS and it is obvious that this proposal would find support amongst existing generators.

However existing generators' gain is at the expense of electricity consumers who will continue to pay - through TUoS charges - for assets that no longer perform shared network services. The NGF Rule change will result in TUoS charges that are not consistent with TUoS costs. The NGF's proposed Rule changes shifts the risk of network reconfiguration affecting existing generators away from those generators and onto electricity users.

In addition, it bears noting that prospective future generators who do not stand to benefit from the arrangement in the same way, and who will be at a relative competitive disadvantage as a result of this proposal, have no voice in this debate.

Analysis of the NGF's justification

The NGF has provided three reasons to support their proposal:

- It reduces inefficiency;
- It reduces regulatory uncertainty; and
- It reduces inconsistency in the treatment of generators.

The efficiency argument

The efficiency argument is that providing new price signals to existing generators cannot have any locational signaling function and hence cannot influence the future behavior of established generators since the costs in

construction etc have already been incurred. The EUAA agrees that in many (but not all cases) changing connection costs has no locational signal. However, this does not lead to the conclusion that changing the cost allocation arrangements as argued by the NGF reduces inefficiency: if changing connection charges has no signaling function then, like changes in other fixed costs, it has no effect on efficiency. It does not reduce inefficiency, as the NGF suggests.

Furthermore, the EUAA suggests that connection charges that do not properly reflect costs can in some circumstances *increase* inefficiency. For example, an existing generator may make different investment decisions – for example to invest to extend the life of an existing plant, or change technology - if it faces lower connection costs in future. If such investment would not occur unless transmission users were subsidizing generator connection costs, then by definition such investment is inefficient.

The regulatory uncertainty argument

The NGF has cast this issue as regulatory uncertainty following a “regulatory Rule review” and that regulatory uncertainty is contrary to “market interests” which we surmise means that rates of return would be higher than they would otherwise be, that investment would be stifled and so on. The EUAA considers that this argument is flawed in many ways:

- It is wrong to cast it as a regulatory uncertainty issue. Network connection charges change over time. Connection versus shared network definitions adapt over time. They have done so for decades before the existing Rules were written, and will continue to do so in future. Existing generators in the NEM by definition have already taken on board these risks. There is nothing particularly “regulatory” about this issue. It is simply part of an on-going adaptation process in the treatment and definition of transmission costs.
- It is inappropriate to reject change because it results in “uncertainty”. Following this argument to its logical conclusion would see the ossification of regulatory arrangements and the NEM, rather than progressive adaptation to changing circumstances. Constancy is not a sacrosanct policy objective.
- It is important to remember that the electricity generation industry in the NEM is not a regulated industry. Generators have no special claim on regulatory certainty. When faced with changes in its other input costs such as coal contracts or labour contracts, arguments of regulatory certainty hold little water. Why should changes in connection costs be any different?
- Finally, risks of changes to connection costs, like other input cost risks are diversifiable. It is not right to claim that exposure to this risk justifies higher rates of return, or that exposure to this risk would stifle generation investment.

The generator consistency argument

The NGF argues that *“The Rule change promotes consistency between classes of generators since ... it would prevent inefficient cost shifting from historically shared assets to any dedicated generator connection assets whether constructed or reconfigured pre or post February 2006.”*

This is misleading. The basis of the NGF’s rule change is specifically that generators connected in the NEM at 16 November 2006 should have preserved rights to insulation from network reconfiguration risk. This same arrangement does not apply to generators connecting after this date. For example, a new generator wishing to

connect in future cannot lay claim to connection costs that it would have occurred if it connected at some point in the past, rather than the charges that it faces connecting today. Clearly the NGF's proposal promotes inconsistency in the treatment of generators, exactly the opposite to their claim.

Summary

The NGF's proposal is to insulate generators connected to the NEM at 16 November 2006 from network reconfiguration risk, by passing this risk – and resulting costs if it materialises - onto consumers. Effectively the NGF is proposing that the interests of existing generators are pre-eminent and that serving those interests above those of electricity consumers or future generators, promotes the National Electricity Objective. This is little more than the promotion of sectoral interests or, in the contemporary jargon, rent-seeking behaviour.

The EUAA considers that the NGF has provided no good reason to justify its proposed Rule Change. To the contrary, the EUAA considers that the NGF proposal:

- Has the prospect of promoting inefficient generation investment
- Discriminates between connection costs payable by existing and new generators; and
- Burdens consumers with risks that should rightly sit with generators who have the ability to manage and diversify them.

Please contact me if you would like to discuss this submission in greater detail. We look forward to participating in subsequent stages of this Rule Change application.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Roman Domanski', with a stylized flourish at the end.

Roman Domanski
Executive Director