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Dear Dr Tamblyn

***Rule Change Proposal:
Economic Regulation of Transmission Services Undertaken by Distributors***

EnergyAustralia wishes to make a further submission in relation to the above rule change proposal submitted by EnergyAustralia to the AEMC on 21 March 2007.

EnergyAustralia understands from the Commission's comments, extracted below, that, while supportive of EnergyAustralia's approach, temporal obstacles precluded it from making a determination within the normal process time frames:

"The AEMC's preliminary view is that there could be potential benefits in making a rule that allows for a single regulatory determination and transmission pricing where a distributor has material transmission assets. The AEMC's preliminary view is based on the principles of good regulatory practice and ensuring that the allocation of costs to network users reflects the assets and services they use. Noting these potential benefits and the temporary nature of the implementation hurdle, the AEMC considers there is sufficient reason to postpone the consideration of the Rule change proposal to a time when it can be assessed within the intended regulatory framework in which the AER is the single regulator for distribution and transmission services."

Whilst there have been several developments since the rule change proposal was submitted, EnergyAustralia's submits that the AEMC should proceed to make the rule proposed by EnergyAustralia, with some modifications to reflect recent changes to the Rules made as part of Economic Regulation of Distribution Services (2007 amendments).

The most important development relevant to this rule change is that the issue that EnergyAustralia was attempting to resolve through the Rule change process was considered by the MCE and addressed (for the 2009-2014 regulatory control period only) by the Economic Regulation of Distribution Services (2007 Amendments) to the rules.

As you would be aware, these amendments to the rules were made on the recommendation of the MCE as part of the recent package of reforms implemented with the National Electricity (South Australia) (National Electricity Law- Miscellaneous Amendments) Amendment Act 2007 which commenced on 1 January 2008.

The Economic Regulation of Distribution Services (2007 Amendments) included a new Part M in Chapter 11 of the Rules. Part M in turn applies Appendix 1 as a transitional Chapter 6 to apply to



NSW and ACT DNSPs for the upcoming regulatory control period 2009-2014, these are referred to as the transitional Chapter 6 rules.

Therefore the Rules which will apply to our next (2009) regulatory determination address the problem identified in EnergyAustralia's Rule proposal, albeit temporarily. EnergyAustralia believes that this policy development should be taken as recognition by the MCE that the objective of EnergyAustralia's rule change proposal (ie. a single revenue determination process but with the application of transmission pricing arrangements) is the appropriate one for a DNSP in EnergyAustralia's position within the NEM. On this basis, EnergyAustralia urges the Commission to implement the MCE's approach as part of the general Chapter 6 rules, together with more general provisions which would allow other DNSPs to apply to the AER for a similar outcome. We explain below in detail the effect of the transitional rules for both EnergyAustralia and other ACT and NSW DNSPs.

Another important development since the lodgement of our original proposal is new obligations placed on the AEMC when considering rule proposals of this nature. We also discuss how our proposed changes are consistent with the revenue and pricing principles further below.

Position of EnergyAustralia under the Transitional Rules

The transitional Chapter 6 rules include provisions 6.1.5 and 6.1.6. Rule 6.1.6 applies only to EnergyAustralia and has the effect of applying the transitional Chapter 6 to EnergyAustralia's prescribed transmission services so that they are treated as standard control distribution services and subject to a single building block proposal and revenue determination. For the purposes of pricing, however, the portion of revenue attributable to the provision of prescribed (transmission) standard control services will be subject to Part J of Chapter 6A and priced as transmission services. These provisions recognise EnergyAustralia's unique position as a distribution network service provider providing both distribution and transmission services under a single network and applies the most efficient regulatory solution to reflect this position.

EnergyAustralia submits that the effect of clause 6.1.6 of the Chapter 6 transition rules should be carried over as part of the general Chapter 6 Rules (with some minor modification discussed below) so that it continues for future determinations. Whilst this position was only accepted on a transitional basis by the MCE as part of the Economic Regulation of Distribution Services (2007 Amendments), dynamic efficiency principles would dictate that this position should continue in the absence of any indicators which undermine the efficiency and efficacy of the MCE's solution.

EnergyAustralia is of the opinion that the MCE's decision to implement this regulatory solution as a transitional rule reflected the need to address EnergyAustralia's problem in the short term without interfering with the AEMC's decision making process.

The problems identified by EnergyAustralia in its Rule change proposal are further exacerbated by the divergence in regulatory frameworks for transmission and distribution. In the absence of amendments to the Transitional Rules, EnergyAustralia would have been subject to two significantly different regulatory frameworks and processes. The MCE recognised this and included drafted the transitional rules to address it. It would have been inappropriate for the MCE to amend the general Rules given the consideration of matter by the AEMC. In our opinion, the MCE drafted transitional rules for EnergyAustralia in the expectation that the AEMC would consider more general application through the rule change process.

EnergyAustralia also notes the MCE decision to include within Schedule 1 of the NEL (Subject Matter for National Electricity Rules) express provisions dealing with the issue at hand. Clauses 14A and 14B state subject matter can include:

14A The treatment of parts of a transmission system as forming part of a distribution system for the purposes of making a network revenue or pricing determination.

14B The treatment of parts of a distribution system as forming part of a transmission system for the purposes of making a network revenue or pricing determination.

Position on negotiated transmission and negotiated distribution services

There is one aspect of clause 6.1.6 which is of concern to EnergyAustralia. We would like to take this opportunity to explain this difficulty, which results in EnergyAustralia being required to apply two different connection regimes to its network and erodes some of the benefits derived from having a single determination process.

The issue relates to the implications of being required to completely separate prescribed transmission services and negotiated transmission services and apply a regime to negotiated transmission services which does not apply to distribution services. We believe that related concerns have already led to the recent rule change submitted by the National Generators Forum "Cost Allocation for Transmission Services" and that similar concerns are likely to be the subject of further industry consideration and possible further rule changes.

However the issues are more acute in EnergyAustralia's circumstance. It effectively requires EnergyAustralia to apply two very different frameworks for connecting customers. This is confusing for customers and EnergyAustralia network planning staff – particularly as the two frameworks must operate in parallel. At the same time EnergyAustralia must comply with its obligations under the Electricity Supply Act 1995 (NSW) in respect of customer connections. What results is increasing convolvement of an already complicated connections process.

Indeed, EnergyAustralia has referred the matter of its interpretation of the delineation between negotiated service and prescribed service for the consideration of the AER. The practical application of the Rules to a current customer negotiation leads us to believe the provisions are proving unworkable in our circumstance.

Because the frameworks are so different, EnergyAustralia is already experiencing the potential for customers to "voltage shop" (request pricing options for connection to lower voltage distribution and higher voltage transmission). This means that rather than seeking the best economic or engineering solution, customers are seeking the best (or least cost) regulatory solution to meet their connection requirements. In EnergyAustralia's opinion, this does not advance the NEL Objective.

The effect of carrying over clause 6.1.6 will be that services provided by EnergyAustralia's transmission support network will need to be divided into Prescribed Transmission Services and Negotiated Transmission Services as if Chapter 6A applied. EnergyAustralia's prescribed transmission services would then be classified as direct control and further as standard control services and subject to a building block proposal under Chapter 6 in the same way as other standard control services (but subject to pricing as if Chapter 6A applied). EnergyAustralia's Negotiated Transmission Services will be retitled "Negotiated Distribution Services" and subject to a negotiating framework under Part D of the general Chapter 6 rules. These services will be totally separate from EnergyAustralia's standard control (transmission and distribution) services and priced under the negotiating framework.

In contrast, you may have noted that there are no separate distribution services classified as "negotiated" under the transitional Chapter 6. The MCE recognised that for NSW and the ACT, there were no services which should be completely separated out from direct control services. It did however recognise that there may be a negotiable component of distribution services, which should be subject to a negotiation framework, but that the underlying direct control service should not be seen as separate from the negotiable component. EnergyAustralia understands that jurisdictional differences prevented the negotiable component approach being adopted in the general Chapter 6 rules.

EnergyAustralia's view is that the transitional Chapter 6 arrangements will at some point in the future be brought over into the general Chapter 6 rules because the current arrangements in the general Chapter 6 regarding negotiating distribution services will be found to be unworkable and inappropriate in the

context of the provision of distribution services. The transitional Chapter 6 Rules implement a much more appropriate regime in that they recognise that the negotiable component of distribution services is inseparable from the underlying direct control service. EnergyAustralia anticipates that this is another matter that will need to be addressed through further rule changes.

EnergyAustralia is preparing its upcoming regulatory proposal on the basis that it will have to delineate between negotiable transmission services and prescribed transmission services, but urges the Commission to consider whether this is appropriate as the ongoing arrangement and whether it would be far preferable for all services provided by a DNSP with transmission assets to be subject to uniform regulatory arrangements. This could be achieved by modifying the effect of clauses 6.1.6(c) and (d) so that all services provided by EnergyAustralia's (or any other DNSP's) transmission support network are classified as direct control and standard control services. Those services would then be subject to the negotiable component provisions in the same way as distribution services.

We discuss below how clause 6.1.6 could be carried over as part of EnergyAustralia's rule change proposal.

Position of other NSW and ACT DNSPs

Clause 6.1.5 applies to the other NSW DNSPs and to ActewAGL. The effect of clause 6.1.5 is the same as clause 6.1.6 except that it does not provide for the application of Part J of Chapter 6A. This was on the basis that none of the other DNSPs currently operated transmission network that had been the subject of a separate regulatory determination and transmission pricing. The inclusion of the provision was an acknowledgement that it was possible that part of those DNSP's networks may, by virtue of their support function, be classified as transmission for the 2009-2014 regulatory control period and that if this occurred there should be one determination.

For similar reasons to that put forward in relation to clause 6.1.6, it would appear appropriate for clause 6.1.5 to be carried over into the general Chapter 6 Rules.

Form in which Rule Proposal should now be made

The suggested draft Rule which accompanied EnergyAustralia's rule change proposal was obviously prepared prior to the drafting of both the new and transitional Chapter 6 Rules. That draft was prepared on the basis of DNSPs having the option of applying to the AER for a single revenue determination under Chapter 6 of the Rules and in addition for the further option of alternative pricing arrangements to apply.

In relation to NSW and ACT DNSPs it is no longer necessary for an application to be made to the AER for a single determination process. As we noted above, the MCE has considered the position of EnergyAustralia and the other NSW/ACT DNSPs and determined that they should be the subject of a single determination process, and in the case of EnergyAustralia, transmission pricing should continue to apply. The arrangements under the transitional Chapter 6 rules should therefore be carried over into the general Chapter 6 as the permanent arrangement. However for DNSPs other than EnergyAustralia it would still be appropriate for an application to be made to the AER for alternative pricing arrangements.

In relation to DNSPs outside NSW and ACT, it is possible that those DNSPs may, at some point in the future, own and operate assets that technically should be categorised as part of the transition network. There should be a mechanism under the Rules for those DNSPs to apply for a single determination process.

In light of the above, EnergyAustralia submits that the draft Rule should be structured as follows:

- The effect of the existing clause 6.1.6 of the Transitional Rules should be included in the general Chapter 6, modified so that all services provided by the transmission support network are classified as direct control and standard services ;

- The effect of the existing clause 6.1.5 of the Transitional Rules should (subject to the views of other NSW and ACT DNSPs) should be included in the general Chapter 6;
- The rule change proposed by EnergyAustralia should be included in the general Chapter 6, however consideration should be given to modifying the drafting so that the same terms as are used in clauses 6.1.5 and 6.1.6 are applied.

Implication of recent amendments to the NEL

As you would aware, on 1 January 2008, changes to the NEL commenced which amended the Rule change process which must be followed by the AEMC.

Specifically, section 91A recognises that the AEMC may make a rule that is different (including materially different) from a market initiated rule such as that made by EnergyAustralia. The AEMC may do this if it is satisfied that, having regard to the issue or issues that were raised by the market initiated proposal, the more preferable rule will or is likely to better contribute to the achievement of the national electricity objective.

EnergyAustralia submits that the AEMC should make the rule on the basis of the structure outlined above as a more preferred rule given the changes which have occurred since the proposal was made. Such a rule will or is likely to better contribute to the achievement of the national electricity objective as it will remove the need for EnergyAustralia and the other NSW and ACT DNSPs to undertake any further processes to facilitate the application of the most efficient regulatory practice for DNSP in our position.

EnergyAustralia also notes that section 88B of the NEL now requires the Commission to take into account the revenue and pricing principles when making a rule of this nature. This proposed rule seeks to ensure that the most efficient regulatory controls apply to DNSPs networks which have transmission support functions. The revenue and pricing principles do not directly address efficient regulatory process but economic efficiency is implicit in the principles, in particular principle 3 relating to the promotion of economic efficiency.

Principle 4 requires the AEMC to have regard to the regulatory asset base adopted in any previous determination or in the Rules. As the transitional rules require the roll forward of both transmission and distribution assets under one regulatory asset base (and the AER to make a determination on the single network regulatory asset base), the general application of the approach adopted by the MCE would be consistent with the revenue and pricing principles.

Some of the issues discussed here are complex and will obviously involve careful consideration by the Commission. For this reason EnergyAustralia has not prepared a further draft of the Rule to reflect the approach to the rule put forward in this submission. Rather we put forward the proposition that the existing drafting of transitional rules, along with the drafting provided in our regulatory proposal is an appropriate starting point for AEMC consideration. EnergyAustralia would however be happy to expand or further explain this submission and to participate further in the development of such drafting if this would assist the Commission.

Yours sincerely,



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