AEMC

RULE CHANGE

Australian Energy Market Commission

RULE DETERMINATION

National Electricity Amendment (Transmission Network Prices Publication Date) Rule 2009

Rule Proponent(s)

EnergyAustralia

26 March 2009

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About the AEMC

The Council of Australian Governments, through its Ministerial Council on Energy, established the Australian Energy Market Commission (AEMC) in July 2005 to be the Rule maker for national energy markets. The AEMC is currently responsible for Rules and policy advice covering the National Electricity Market. It is a statutory authority. Our key responsibilities are to consider Rule change proposals, conduct energy market reviews and provide policy advice to the Ministerial Council as requested, or on AEMC initiative.

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Abbreviations

AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
ASRR	Annual Service Revenue Requirement
Commission	see AEMC
CPI	Consumer Price Index
DNSP	Distribution Network Service Provider
MAR	Maximum Allowed Revenue
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
Rules	National Electricity Rules
TNSP	Transmission Network Service Provider
TUoS	Transmission Use of Service

Summary

On 27 June 2008 the Commission received a Rule Change proposal from EnergyAustralia that proposed to move the transmission network prices publication date for categories of prescribed transmission services from the 15 May to the 15 March each year.

The main arguments proposed by EnergyAustralia in support of the proposed Rule were that it would reduce the administrative burden associated with the price approval process; would induce more efficient and accurate pricing signals for customers; and enable DNSPs to avoid financial exposure. However, submissions challenged these claims.

The Commission assessed EnergyAustralia's Rule Change proposal and found that the proposed Rule did not meet the statutory Rule making test. The Commission decided this on the basis that the proposed Rule would not be a proportionate response to the problem identified and thus would be inconsistent with good regulatory practice. The Commission also found that, on the information available to it, the problem identified was not material and was specific to New South Wales.

During second round consultation, TransGrid proposed an alternative Rule which sought to use the draft Maximum Allowed Revenue (MAR) in calculating transmission prices during the first year of a regulatory control period if the final MAR is not available. The effect of the proposed Rule would be to facilitate the earlier publication date of transmission network prices and give sufficient time for DNSPs to incorporate transmission network prices into their price-setting processes. The alternative Rule would also provide for any over or under recovery arising from differences between the draft and final MAR to be adjusted in subsequent periods. The Commission conducted consultation regarding TransGrid's alternative Rule in accordance with section 107A of the NEL with respect to the specific issue of using the draft MAR to calculate transmission prices during the first year of a regulatory control period. Submissions received were supportive of TransGrid's alternative Rule.

The Rule as Made is reflective of TransGrid's alternative Rule. The Commission's analysis found that the Rule as Made meets the statutory Rule making test. The Rule as Made minimises cash-flow flow risk faced by DNSPs as transmission prices are received earlier in the price-setting process and improves the ability of DNSPs to pass more timely and efficient transmission price signals onto consumers. The Rule as Made is a permissive clause and need not mandate a change throughout the NEM. Further, the Rule as Made would be conducive to efficiency benefits for relevant jurisdictions. The Rule as Made addresses, in a proportionate manner, the problem that was initially put forward by EnergyAustralia.

1 EnergyAustralia's Rule Change Proposal

1.1 Proposal

On 27 June 2008 the Commission received a Rule Change proposal from EnergyAustralia.[1] It proposed that the date of annual publication by Transmission Network Service Providers (TNSPs) of their prices for *categories of prescribed transmission services* (referred to as 'transmission prices') be moved from 15 May to 15 March each year (Rule Change Proposal).[2]

EnergyAustralia stated that the purpose of the Rule Change proposal is to permit transmission prices to be properly incorporated into distribution prices to apply in the following financial year and significantly streamline the price approval process for both the regulator and Distribution Network Service Providers (DNSPs).[3]

EnergyAustralia requested that the Rule Change Proposal be expedited under section 96 of the National Electricity Law (NEL) because, in its view, the request was for a non-controversial Rule.[4]

1.2 Problem to be addressed by the Rule Change

EnergyAustralia states that DNSPs bear a risk forecasting transmission prices. Accordingly, the proposed Rule Change seeks to address the issue that DNSPs may, at times, be unable to effectively incorporate transmission prices into their distribution pricing and approval process. In EnergyAustralia's view, this is because the date for publication of transmission prices is too late. DNSPs rely on estimates of transmission prices which may materially differ from actual transmission prices. This leads to DNSPs bearing forecasting risk with consequences for their revenue recovery.[5]

The National Electricity Rules (Rules) provide that transmission prices must be published by 15 May each year for the purposes of determining *distribution service prices.*[6] However, under the Rules, in the first year of a five year *regulatory control period*, DNSPs must submit their *initial pricing proposal* to the Australian Energy Regulator (AER) within 15 *business days* after the publication of a distribution determination.[7] The Rules also provide that the AER must publish a distribution determination no later than two months before the commencement of a *regulatory*

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[1] EnergyAustralia, *Rule Change Proposal: Variation of Date of Publication of Transmission Network Prices*, 27 June 2008 (Rule Change Proposal)

[2] Terms in italics have the same meaning as they have in the Rules.

[3] Rule Change Proposal, p 1

[4] Rule Change Proposal, p 5

[5] Rule Change Proposal, p 2-3

[6] Clause 6A.24.2 of the Rules

[7] Clause 6.18.2(a) of the Rules

control period.[8] Accordingly, if the AER published a distribution determination by 1 May at the latest, then the *initial pricing proposal* would need to be published by 15 May. For subsequent years within a *regulatory control period* (non-regulatory reset years), DNSPs must submit their annual *pricing proposal* to the AER at least two months before the commencement of the upcoming regulatory year.[9] The situation arises that for non-regulatory reset years the submission of annual distribution pricing proposals falls before the publication of transmission prices. For distribution pricing proposals due in a regulatory reset year, transmission prices are only received marginally before, or at the same time, as when distribution pricing proposals are due.

According to EnergyAustralia, DNSPs must rely on estimates based primarily on transmission prices from previous years. If DNSPs find that a TNSP's published prices are materially different from earlier estimates, then DNSPs may either:

- accept that a material over or under recovery of transmission use of system charges (TUoS) will occur the following financial year; or

- request the regulator to allow them to resubmit their prices. However, there is only a short timeframe for DNSPs to recalculate their prices and for the AER to approve it.[10]

1.3 Proponent's proposed solution

EnergyAustralia's proposed solution is that TNSPs be required to publish transmission prices two months earlier; that is, 15 March rather than 15 May of each year.

EnergyAustralia argued that its Rule Change proposal would give DNSPs sufficient time to receive finalised transmission prices so that these prices could be incorporated into their distribution pricing proposals.[11] This would eliminate any forecasting risk on the part of DNSPs because they would receive actual transmission prices.

Energy Australia also argued that customers, particularly large customers, would benefit from having up-to-date transmission price signals because it would reduce price variability.[12]

1.4 First Round Consultation

On 24 July 2008, the Commission published a notice under sections 95 and 96 of the NEL stating its intention to consider the Rule Change Proposal under an expedited

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[8] Clause 6.11.2(2) of the Rules

[9] Clause 6.18.2(a)(2) of the Rules

[10] Rule Change Proposal, p 3

[11] Rule Change Proposal, p 4

[12] Rule Change Proposal, p 4

Rule making process, subject to the receipt of written objections on the expedited Rule making process. Interested parties had until the 8 August 2008 to submit written objections.

On 8 August 2008, a written objection from Grid Australia was received. Grid Australia's view was that this Rule Change raised issues sufficiently complex for it not to be treated as a non-controversial Rule.

Grid Australia raised the following concerns with respect to an earlier transmission prices publication date:

- greater inaccuracy of forecast transmission pricing estimates as a result of two months less actual data;
- less certainty in the calculation of current year and forecast inter-regional settlement residues;
- less certainty in the calculation of current year revenue recovery for TNSPs; and
- additional price volatility which will impact upon TNSP's 'unders and overs' account leading to a distortion in the accuracy of TUoS prices.

Further, Grid Australia raised a number of issues pertaining to the practical implementation of the Rule Change Proposal. The Commission found that the written objection was not misconceived or lacking in substance. Accordingly, the Rule Change Proposal has been considered under the ordinary statutory rule making process.

On 22 August 2008, first round consultation closed and a total of six submissions were received. Four of those submissions (Integral Energy, Country Energy, Energex and EnergyAustralia) supported the Rule Change Proposal arguing it would streamline the pricing approval process and apportion a better balancing of forecasting risk. Two of the submissions (Grid Australia, VENCorp) were critical of the Rule change proposal for reasons similar to the written objection from Grid Australia noted above.

On 16 October 2008, the Commission published a notice under section 107 of the NEL to extend the publication of the draft Rule determination to 20 November 2008. The Commission considered that it was necessary to extend the period of publication to consider new information in its draft Rule determination arising through consultation.

1.5 Second Round Consultation

On 20 November 2008, the Commission published a notice under section 99 of the NEL advising of the making of a draft Rule determination in respect of the Rule Change Proposal. The Commission decided not to make the proposed Rule because it considered it would not satisfy the NEO.

On 23 January 2009 the second round consultation period on the draft Rule determination closed. Submissions were received from TransGrid and EnergyAustralia. The main proposal arising from both submissions was for a Rule Change enabling TNSPs to use the draft decision of the Maximum Allowed Revenue (MAR) in setting transmission prices in the first year of a regulatory control period.

TransGrid's Submission

TransGrid submitted a proposal requesting that a Rule be made to enable TNSPs to use the draft decision of the MAR in setting transmission prices in the first year of a regulatory control period.

TransGrid noted that Clause 6A.24.3 of the Rules enables a TNSP to use the draft decision of the AER regarding a particular TNSP's transmission pricing methodology in order to set prices in the first year of a regulatory control period. TransGrid argued that a similar arrangement whereby TNSP could use a draft MAR in setting transmission prices should be explicitly stipulated in the Rules.[13] Further, TransGrid argued that the absence of a Rule expressly stating which MAR to apply to the transmission pricing methodology in the absence of a final decision was an omission in the Rules that should be addressed.[14]

The consequence of making such a Rule would be to facilitate the earlier publication date of transmission prices. This would enable DNSPs to have adequate time to consider such transmission prices and properly incorporate them in their pricing proposals and in so doing address the concerns that motivated the EnergyAustralia Rule change proposal.

EnergyAustralia's Submission

EnergyAustralia's second round submission reiterated its position that the Rule Change Proposal was necessary in order to prevent cash-flow risk that may result from it receiving a relatively late publication date of transmission prices. EnergyAustralia expressed its disappointment that the Commission had decided to reject its proposed Rule in its draft Rule determination.

However, EnergyAustralia notified the Commission that it had signed a Memorandum of Understanding (MOU) with TransGrid to receive published transmission prices at an earlier date than was currently stipulated in the Rules. In order for the arrangements in the MOU to be given effect, EnergyAustralia expressed

[13] TransGrid, Submission to Second Round Consultation, pp 1-2.

[14] TransGrid, Submission to Second Round Consultation, p 3.

its support for TransGrid's proposal for the AER's draft decision of the MAR to be used in the transmission price setting process for the first year of a regulatory control period.[15]

1.6 Additional Consultation

On 12 February 2009, the Commission published a notice under section 107A of the National Electricity Law (NEL) to extend the publication date of the final Rule determination by three weeks to 26 March 2009 to allow for additional consultation on a specific issue.

The specific issue requiring additional consultation was TransGrid's proposal permitting TNSPs to use the draft MAR during the first year of a regulatory control period to calculate transmission prices. This would enable TNSPs to provide to DNSPs transmission prices at an earlier date. DNSPs could then use these prices in their price-setting process.

By the close of consultations on 6 March 2009, submissions were received from EnergyAustralia and Integral Energy. Both submissions supported TransGrid's alternative Rule proposal. EnergyAustralia noted that the alternative Rule would alleviate the financial risk it faces and enable TransGrid to bear the revenue variation resulting from differences in the draft and final MAR.[16]

[15] EnergyAustralia, Submission to Second Round Consultation, pp 1-2.

[16] EnergyAustralia, Submission to Explanatory Note, p 1.

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2 Final Rule Determination

2.1 Commission's final Rule determination

In accordance with section 102 of the NEL, the Commission has made and published this final Rule determination. In accordance with section 103 of the NEL the Commission has made the *National Electricity Amendment (Transmission Network Prices Publication Date) Rule 2009* (Rule as Made).

The Rule as Made will commence on 31 March 2009.

The Rule as Made, which is different from the Rule proposed by EnergyAustralia and is a more preferable Rule, is published with this final Rule determination.

Under section 91A the Commission may make a Rule that is different (including materially different) from a market initiated proposed Rule (a more preferable Rule) if the AEMC is satisfied that, having regard to the issue or issues that were raised by the market initiated proposed Rule (to which the more preferable Rule relates), the more preferable Rule will or is likely to better contribute to the achievement of the NEO.

2.2 Commission's considerations

This final Rule determination sets out the Commission's reasons for making the Rule as Made. In making this Rule determination, the Commission has taken into account:

- the Commission's powers under the NEL to make the Rule;
- any relevant MCE statements of policy principles;
- the revenue and pricing principles set out in the NEL[17];
- the Rule Change Proposal and the proposed Rule;
- submissions received during first and second round consultation;
- submission received during the additional round of consultation on the specific issue raised by TransGrid; and
- the Commission's analysis on the ways in which the proposed Rule will, or is likely to contribute to the National Electricty Objective (NEO) so that the statutory Rule making test is satisfied.

[17] Under section 88B of the NEL the Commission is required to take into account the revenue and pricing principles set out in section 7A of the NEL with respect to any matter or thing specified in items 15-24 and 25-26J of Schedule 1 to the NEL.

In the draft Rule determination, the Commission considered that the Rule proposed by EnergyAustralia would not contribute to the NEO and was not consistent with the revenue and pricing principles. The Commission's reasons for not accepting the proposal to amend the transmission prices publication date in clause 6A.24.2 in the manner requested by EnergyAustralia were that the proposed Rule, if made, would:

- be inefficient as it may require further Rule changes and amendments to practices and processes adopted by TNSPs and the AER. In the interim, it may create considerable uncertainty;
- be inequitable as some TNSPs may not have an opportunity to recover their efficient costs as they do not have an access to an under / over recovery price mechanism. This is inconsistent with one of the revenue and pricing principles (section 7A(2) of the NEL);
- not address the problem as it may be experienced by DNSPs in Victoria, whose prices are amended on a calendar year basis;
- be unlikely to address the consumer price signal issue raised by EnergyAustralia. Rather, as TNSPs would need to develop prices earlier on less accurate information to meet an earlier publication date, they may need to rely further on an under / over recovery mechanism, if such a mechanism was available;
- be inconsistent with good regulatory practice and design as it would be a solution that is disproportionate to the extent and materiality of the problem raised (on the information provided to the Commission); and
- would be inefficient as arguably it is not required. DNSPs in other jurisdictions have managed this problem successfully another way. Further, the Commission understands that EnergyAustralia and TransGrid have negotiated a solution to the problem.

Therefore, the proposed Rule would not satisfy the Rule making test, taking into account the revenue and pricing principles because:

- it would be inconsistent with the principles of good regulatory practice and design;
- it may create uncertainty; and
- it would not provide for consistent treatment across the NEM of TNSPs and DNSPs.

The Commission considers that the Rule as Made will, or is likely to, better contribute to the NEO than the original Rule proposed by EnergyAustralia having regard to the issues raised by the Rule Change Proposal. It is also consistent with the revenue and pricing principles. The Rule as Made addresses a number of the concerns raised by EnergyAustralia as well as those raised by other stakeholders.

The Rule as Made satisfies the Rule making test for the following reasons as it would:

- minimise cash-flow risk faced by DNSPs as transmission prices are received earlier in the price-setting process;
- improve the ability of DNSPs to pass on to consumers more timely and efficient transmission price signals;
- enable a more equitable sharing of risk whereby TNSPs bear the revenue variation arising from differences in draft and final MAR while alleviating financial risks faced by DNSPs;
- not mandate or obligate a change across the NEM, rather it is a permissive clause that facilitates earlier publication date of transmission prices for those jurisdictions where this is an issue. Processes and procedures in other jurisdictions would not be affected;
- be consistent with principles of good regulatory practice in so far as the Rule is a proportionate response to the materiality of the problem; and
- be conducive to efficiency benefits for those jurisdictions where earlier publication date of transmission prices is considered to be desirable.

Accordingly, the Commission is satisfied that the Rule as Made contributes to the achievement of the NEO because it promotes efficient investment in, and efficient operation and use of electricity services for the long term interests of consumers of electricity with respect to the price of electricity.

Further, the Commission must also have regard to MCE statements of policy principles for the purposes of making the Rule as Made.[18] However, there are no relevant MCE statements of policy principles applicable in this instance.

Moreover, the Rule as Made is consistent with the revenue and pricing principles which provide, amongst other things, that regulated network service providers should be provided with a reasonable opportunity to recover at least the efficient costs they incur in providing direct control network services.[19]

2.3 Commission's power to make the Rule

The Commission is satisfied that the proposed Rule falls within the subject matters that the Commission may make Rules as set out in section 34 of the NEL and in Schedule 1 to the NEL. The proposed Rule is within:

- The matters set out in section 34 (1)(a)(iii), as it relates to the activities of persons participating in the NEM or involved in the operation of the national electricity system.

[18] Section 88(2) of the NEL.

[19] Section 7A(2)(a) of the NEL.

- The matters set out in items 15- 24 of Schedule 1 of the NEL as it relates to transmission system revenue and pricing. In particular, item 16 relates to the regulation of prices charged or that may be charged by owners, controllers or operators of transmission systems for the provision by them of services that are the subject of a transmission determination.

3 Commission's assessment against NEL criteria

This Chapter sets out the Commission's assessment of EnergyAustralia's Rule Change Proposal and the alternative proposal submitted by TransGrid and the Commission's reasons for making the Rule as Made.

3.1 Methodology

In assessing any proposed Rule change against the Rule making test, one must consider the counterfactual arrangements against which the Rule change is being compared in light of the NEO. In the present case, the relevant counterfactual would be a continuation of present arrangements under which EnergyAustralia would receive transmission prices annually on 15 May.

These arrangements have been assessed against the main arguments put forward by EnergyAustralia in support of the proposed Rule change being:

- a reduced administrative burden associated with the price approval process;
- more efficient and accurate pricing signals for customers; and
- the avoidance of financial exposure.

These arrangements have also been assessed against the main arguments put forward by TransGrid in support of its alternative Rule being:

- the minimisation of the cash-flow risk faced by DNSPs as transmission prices are received earlier in the price-setting process; and
- the improvement of the ability of DNSPs to pass on to consumers more timely and efficient transmission price signals.

3.2 Rule making test and the National Electricity Objective

The Rule making test states that the Commission may only make a Rule if it is satisfied that the Rule will, or is likely to, contribute to the achievement of the NEO.[20] The NEO is set out in section 7 of the NEL as follows:

> The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system.

[20] See section 88(1) of the NEL

The NEO is founded on the concepts of economic efficiency (including productive, allocative and dynamic dimensions of efficiency), good regulatory practice (which refers to the means by which regulatory arrangements are designed and operated) as well as reliability, safety and security priorities.

3.3 Revenue and pricing principles

As the matter raised by this Rule Change Proposal relate to the regulatory framework governing transmission revenue and pricing, the Commission must also take into account the revenue and pricing principles (set out in section 7A of the NEL).

The revenue and pricing principles relate to providing a reasonable opportunity for regulated network service providers to recover at least the efficient costs, effective incentives to promote efficiency and to ensuring that prices should allow for a return commensurate with the regulatory and commercial risks involved in providing the service.

3.4 EnergyAustralia's Proposed Rule

3.4.1 Reduced administrative burden

In its Rule Change Proposal, EnergyAustralia claimed that its proposed Rule would meet the NEO as it would significantly streamline the annual price approval process for the majority of distribution businesses and for the AER.[21] The proposed Rule would reduce the administrative burden experienced by distribution businesses and the AER of multiple revisions to distribution prices caused by reliance upon estimates of transmission prices.

By contrast, in its submission made during the first round of consultation Grid Australia raised a number of issues that would need to be addressed if the Rule Change Proposal were to be accepted. VENCorp also expessed concern regarding the Rule Change Proposal.[22] These issues would create additional legal and administrative burdens and would need to be resolved for the proposed Rule to be applied. The issues included:

- For years prior to the commencement of a new regulatory control period, either the previous year's pricing methodology or a draft pricing methodology would need to be used because the AER's approval of final transmission pricing methodologies for that regulatory period would only occur by the end of April.[23] This would also require a Rule change.

[21] EnergyAustralia noted that the five Victorian distribution businesses set prices each calendar year.

[22] VENCorp, Submission to First Round Consultation, p 1.

[23] Grid Australia, Submission to First Round Consultation, p 7.

- An earlier transmission prices publication date would require the use of less accurate CPI data; it would require either December quarter CPI data or substitute a forecast for the March CPI data.[24]

- It may be necessary for adjustments to the Maximum Allowed Revenue (MAR) (for example, adjustments to the MAR for service target performance incentive scheme) to be either accommodated in the year in which it occurs or be carried over to adjustments made in subsequent years along with compensation for any foregone regulated returns due to the delay in revenue recovery.[25]

- The results of March quarter settlement residue auction proceeds would enable the required matching of settlement residue auction receipts with refunds to customers via the transmission pricing process. As VENCorp also notes, an earlier publication date would reduce accuracy of pricing forecasts that TNSPs use for TUoS prices as March quarter settlement residues would not be included.[26] Grid Australia stated that the earliest time that TNSPs could publish prices that make use of this information each year is early April and publication any time earlier would result in far less accuracy.[27]

- For an earlier transmission prices publication date, the coordinating TNSP for a given region must obtain information from its regional TNSPs at a much earlier time.[28]

- Information on energy consumption, maximum demand and network configuration would be less accurate if it had to be provided in line with an earlier publication date.[29]

VENCorp suggested that an earlier publication date would create unrealistic timeframes for TNSPs to calculate and approve TUoS prices.[30] This is particularly an issue for coordinating TNSPs who are dependent upon forecasts from the other TNSPs in their region. If an earlier publication date was mandated, then there would be significant variances between forecast and actual prescribed transmission service charges. If the Rule change is adopted then the Rules must be amended to include an obligation on parties providing information to coordinating TNSPs.

VENCorp also disagreed with EnergyAustralia's claim that transmission prices could be calculated based on CPI escalation from the January quarter result, rather than the March quarter.[31] If CPI escalation was used, VENCorp could potentially breach its Network Service Agreement with its transmission service providers. Consequently,

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[24] Grid Australia, Submission to First Round Consultation, p 7.

[25] Grid Australia, Submission to First Round Consultation, p 8.

[26] VENCorp, Submission to First Round Consultation, p 3.

[27] Grid Australia, Submission to First Round Consultation, p 8-9.

[28] Grid Australia, Submission to First Round Consultation, p 9.

[29] Grid Australia, Submission to First Round Consultation, p 10.

[30] VENCorp, Submission to First Round Consultation, p 2.

[31] VENCorp, Submission to First Round Consultation, p 3.

VENCorp would then need to amend its Network Service Agreements with other TNSPs, which incurs legal and administrative costs.

During second round consultation, TransGrid submitted an alternative Rule in which it proposed that the Rules be changed to allow the draft MAR to be used by TNSPs to calculate transmission prices during the first year of a regulatory control period.[32] TransGrid argued that by allowing TNSPs to use the draft MAR, this would enable it to calculate transmission prices and publicise those prices at an earlier date for use by DNSPs in their price-setting processes. TransGrid contended that this would contribute to achieving the NEO because it would minimise administrative costs incurred by DNSPs in preparing and publishing pricing proposals and administrative costs of AER approving such pricing proposals.[33] TransGrid accordingly claimed that this would promote the efficient operation of electricity services.

3.4.2 Price signals

In its Rule Change Proposal, EnergyAustralia stated that transmission prices published on 15 May cannot be satisfactorily factored into distribution prices. If the published transmission prices differ materially from estimates then the DNSP could expect that a material over or under recovery to occur in the following year or it could request the regulator to allow the DNSP to resubmit its prices to the regulator (this can occur only in a short time frame).[34] Accordingly:

> "[a] casualty of this sequence of events is the price signals which are passed on by the TNSP to the DNSP, which are intended to influence customers' consumption patterns. Even if the DNSP resubmits its prices, the cost allocation at specific locations is, of necessity, simply scaled to match the required transmission revenue to be recovered."[35]

In EnergyAustralia's view, the proposed Rule would significantly improve signalling of transmission prices to customers by reducing price volatility.[36] EnergyAustralia claimed that improving communication of price signals would minimise the overall costs of supply and encourage efficient investment in both demand and supply sides. For large customers in particular, EnergyAustralia argued, it is highly desirable that distribution prices fully reflect transmission price signals.

This argument and the one outlined above were supported by the other two New South Wales distribution businesses, Country Energy and Integral Energy. Energex also supported the Rule Change Proposal for these reasons and on the basis that it was reflective of arrangements that exist between Energex and Powerlink. No

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[32] TransGrid, Submission to Second Round Consultation, p 1-2.

[33] TransGrid, Submission to Second Round Consultation, p 4.

[34] EnergyAustralia Rule Change Proposal, p 3.

[35] EnergyAustralia Rule Change Proposal, p 3.

[36] Price volatility arises from a reliance upon price over and under recovery mechanisms when prices are adjusted in the year following the forecast year.

submissions in support of the Rule Change Proposal were received by DNSPs located in jurisdictions other than New South Wales and Queensland.

Grid Australia[37] and VENCorp[38] argued that the proposed Rule would distort price signals. An earlier publication date may lead to greater transmission pricing uncertainty, which affects the 'overs' and 'unders' provision. Significant variations to the 'overs' and 'unders' provisions may distort the locational price signals because relatively more is recovered from the non-locational charges for a given year. This reduces the allocative efficiency of transmission pricing arrangements. Further, such variations in 'overs' and 'unders' provisions may lead to more volatile transmission pricing signals in subsequent years.

During second round consultation, TransGrid submitted an alternative Rule where it proposed that the draft MAR be used to calculate transmission prices during the first year of a regulatory control period. This would enable a TNSP to publish transmission prices earlier and enable DNSPs to incorporate transmission prices into their own price-setting processes. TransGrid argued that this alternative Rule would improve the ability of DNSPs to pass on to consumers more timely and efficient transmission price signals.

3.4.3 Avoided financial exposure

In its first round submission, EnergyAustralia provided additional rationale to that contained in the Rule Change Proposal. It stated that the Rule Change Proposal was motivated by how best to allocate the financial risk arising from forecasting transmission prices for customers in the next financial year:

> "Under the current Rules, EnergyAustralia largely bears this risk as a DNSP. If published transmission prices from TransGrid (on 15 May) are higher than EnergyAustralia's estimate used in calculating proposed distribution prices (on 1 May), EnergyAustralia is financially exposed and only recovers the difference 24 months after the initial prices are set. EnergyAustralia does not have the information to predict transmission prices for the next year and is forced to base prices on simple escalation of previous year prices in the absence of advice from the TNSP…"[39]

EnergyAustralia provided an example of the financial consequences of inaccurate estimations of transmission prices. If published transmission prices were 10% higher than EnergyAustralia's estimate then EnergyAustralia would be short in the amount of TUoS revenue it recovers from customers. A 10% differential would represent around $15 million in revenue. EnergyAustralia stated, however, that it would be able to recover this revenue shortfall through an unders and overs recovery mechanism although it will take almost 24 months to recover the shortfall[40].

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[37] Grid Australia, Submission to First Round Consultation, p 4-5.

[38] VENCorp, Submission to First Round Consultation, p 1.

[39] EnergyAustralia, Submission to First Round Consultation, p 1

[40] EnergyAustralia, Submission to First Round Consultation, p 3.

While acknowledging that the proposed Rule change would result in less certainty for TNSPs, EnergyAustralia maintained that this was preferable to calculating forecast transmission charges with relatively no information.

In its submission, Grid Australia argued that some TNSPs (ie. Victorian TNSPs) do not have access to 'overs' and 'unders' revenue recovery mechanisms in the Rules, and therefore need to be able to calculate their cost allocation and revenue exactly with information only available by late April. Grid Australia concluded that an earlier publication date would leave some TNSPs potentially unable to recover their revenue.[41]

3.5 Commission's Assessment of EnergyAustralia's Proposed Rule

The Commission has assessed the Rule Change Proposal taking into account submissions received during the first and second rounds of consultation and is of the view that the Rule proposed by EnergyAustralia does not meet the statutory Rule making test.

Amending the date for the publication of transmission prices:

- may require further consequential Rule changes, as well as a number of amendments to procedures and practices which have been developed and adopted by the AER and market participants around the data inputs and timing requirements required for the development of transmission prices. While the proposed Rule would reduce the administrative burden faced by DNSPs and the regulator in setting distribution prices, it would create additional burdens on other participants. Unless and until these consequential matters are addressed there could be uncertainty around the data to be used to calculate transmission prices;

- would disadvantage the Victorian TNSPs, in particular, SP Ausnet which does not have access to over/under recovery mechanisms. This would be inconsistent with one of the revenue and pricing principles.[42] Further it would not address the issues raised by EnergyAustralia for Victorian DNSPs (whose prices are amended on a calendar year basis). It would result in inconsistent treatment across the NEM; and

- may not avoid the consumer price signal issue. According to Grid Australia, TNSPs would need to rely on over / under recovery mechanisms if an earlier publication date was adopted. On this basis the price signal risk referred to by EnergyAustralia may not be removed by the proposed Rule; rather it would be moved. In any event, it is not clear the extent to which an earlier transmission price publication date materially affects price signals for the vast majority of consumers, for whom transmission prices constitute a comparatively small component of their overall energy bill.

41 Grid Australia, Submission to First Round Consultation, p 2.

42 Section 7A(2) of the NEL.

Good regulatory practice and design require a proportionate response to any problems raised. A proportionate response should be linked to the extent and materiality of the problem. On the information available to the Commission, the problem identified by EnergyAustralia appears to be specific to New South Wales. In fact, submissions have indicated that other jurisdictions either do not face this problem or there are co-operative arrangements in place that enable DNSPs to have more accurate transmission price estimates which reduces the DNSP's risk.[43]

Further the Commission has not been provided with adequate information that demonstrates that the problem is material. As stated above EnergyAustralia is not actually financially exposed by the problem it has raised. It can recover any shortfall amounts as a result of inaccurate estimates of transmission prices; albeit at a later date. A solution, such as the one proposed by EnergyAustralia, that mandates a change across the NEM, for an issue which only affects DNSPs in one jurisdiction (and indeed may cause significant inconvenience and disturbance to other market participants whose existing arrangements are functioning well, without further changes to the Rules and existing practices and processes) is not a proportionate response to the regulatory problem raised, and therefore inconsistent with good regulatory practice. Such a solution would also be inefficient.

The Commission understands that EnergyAustralia and TransGrid have entered into arrangements under which they have agreed for an earlier publication date for transmission prices. This appears to be a more appropriate solution to the problem as it does not require changes to the Rules that would inconvenience other market participants and the AER and it is appropriately tailored to the relevant jurisdiction.

3.6 TransGrid's Alternative Rule

TransGrid proposed an alternative Rule which, in its view, would facilitate an earlier publication date of transmission prices and thus enable DNSPs to incorporate such transmission prices into their price-setting processes.

3.6.1 The effect of the alternative Rule

As outlined above, TransGrid's alternative Rule would enable TNSPs to use the AER's draft decision on the MAR to set transmission prices during the first year of a regulatory control period. In the situation where the AER has approved a proposed MAR in its draft decision, the TNSP could use that proposed MAR to set transmission prices in the first year of a regulatory control period. In the situation where the AER has refused to approve a proposed MAR in its draft decision, TNSPs could use the MAR that the AER has substituted instead in its draft decision to set prices in the first year of a regulatory control period.

TransGrid's alternative Rule also provides for any under or over-recovery amount arising from differences in the draft and final MAR occurring in the first pricing

[43] Grid Australia, Submission to First Round Consultation, p 5. See also Energex, Submission to First Round Consultation, p 1.

period to be recovered by adjustments to the Annual Service Revenue Requirement (ASRR).

3.6.2 Submissions

The submissions received in response to the additional round of consultation were supportive of TransGrid's alternative Rule. EnergyAustralia noted that TransGrid's alternative Rule would enable TransGrid to bear the revenue variation resulting from differences in the draft and final MAR and alleviate financial risk faced by DNSPs.[44] TNSPs are able to recover the difference between the draft and final MAR through the 'overs' and 'unders' provisions that adjust the ASRR.

3.7 Commission's Assessment of the Alternative Rule Proposed by TransGrid

The Rule as Made is reflective of the alternative Rule proposed by TransGrid. The Commission has assessed the alternative Rule proposed by TransGrid taking into account submissions received during the first and second rounds of consultation and is of the view that the Rule as Made does meet the statutory Rule making test.

The alternative Rule proposed by TransGrid (the Rule as Made) would:

- facilitate the earlier publication date of transmission prices during the first year of a regulatory control period and in so doing mitigates cash-flow risks for some DNSPs due to the current timeframe for publishing prices;

- improve the ability of DNSPs to pass on to consumers more timely and efficient transmission price signals onto consumers;

- be consistent with principles of good regulatory design because the Rule as Made is a simple and proportionate response to the materiality of the issues raised by EnergyAustralia in their original Rule Change proposal. The Rule as Made enables an earlier publication date of transmission prices which would assist distribution network service providers. It would specifically assist EnergyAustralia and other DNSPs in NSW[45] to set their distribution prices and mitigate any cash-flow risk that may ordinarily arise. The Rule as Made would not upset arrangements in other jurisdictions as it is a discretionary Rule and would only apply to TNSPs electing to submit an earlier transmission prices publication date. It is thus proportionate to the extent and materiality of the problem raised by EnergyAustralia;

- not disturb existing price-setting processes in other jurisdictions where an earlier publication date would not be applicable or not considered to be necessary. For example, it would not upset arrangements in Victoria where TNSPs and DNSPs do not have access to 'over' and 'under' arrangements nor

[44] EnergyAustralia, Submission to Explanatory Note, p 1.

[45] See for example, Integral Energy, Submission to Explanatory Note, p 1 and EnergyAustralia, Submission to Explanatory Note, p 1.

would it interfere with cooperative arrangements between DNSPs and TNSPs in Queensland.

- not mandate a change in the NEM but rather provides or facilitates the option for the use of the draft MAR in calculating transmission prices for the first year of a regulatory control period. The Rule as Made has a permissive effect; the Rule as Made may be used at the discretion of a TNSP. The Rule as Made does not create an obligation. The Rule as Made would thus not be a barrier to efficient outcomes, but rather could enhance or facilitate some efficiency benefits for those jurisdictions where an earlier transmission prices publication date is desirable.

- enables a more equitable sharing of risk whereby TNSPs would bear revenue variations from differences in draft and final MAR while alleviating financial risks faced by DNSPs.

- give scope for the correction in subsequent periods of any over or under recovery due to differences between draft and final MAR.

For the reasons stated above, the Rule as Made represents a significant improvement on the initial Rule as it enables certain DNSPs to be able to receive transmission prices earlier and thus addresses the problem that initially motivated this Rule Change. The Rule as Made will, or is likely to better contribute to the NEO than the original Rule proposed by EnergyAustralia, having regard to the issues raised by that Rule Change Proposal.