Transmission Network Prices Publication Date

Response to EnergyAustralia Rule Change Proposal

22 August 2008

Table of Contents

1. Introduction 1

2. Impediments to adjusting TNSP revenue from Year to Year 1

3. Proposal Undermines National Transmission Pricing 2

3.1 The AEMC's Commitment to National Transmission Pricing 3

3.2 Why Proposal is Inconsistent with the Implementation of National Transmission Pricing 4

4. Proposal is Likely to Result in Inefficient Transmission Prices 4

5. Experiences in Other NEM Regions Suggest Better Alternatives to Resolving the Issues Raised 5

5.1 The Victorian Experience 5

5.2 Lessons from South Australia 5

6. Practicality of Earlier Publication of Transmission Prices 6

6.1 The Availability of Price Setting Rules 7

6.2 Establishing the Relevant Maximum Allowed Revenue Each Year 7

6.3 Consumer Price Index Data 7

6.4 Information on Adjustments Required to the Maximum Allowed Revenue 8

6.5 Adjusting for Settlement Residue Auction Proceeds 8

6.6 Information Required by the Co-ordinating TNSP 9

6.7 Information on Energy Consumption, Maximum Demand and Network Configuration 10

6.8 The Importance and Timing Requirements for this Information Varies from Region to Region 10

7. Summary 11

1. Introduction

This submission has been prepared by Grid Australia, which represents the five transmission network services providers operating in the national electricity market; i.e. ElectraNet, Powerlink, SP AusNet, Transend and TransGrid. It addresses the Rule change request lodged by the EnergyAustralia on 25 June 2008 to vary the date of publication of transmission network prices.

In summary, Grid Australia does not support changing the 15 May date specified in the Rules for publication of annual transmission prices. Indeed, mandating an earlier date than 15 May for the publication of transmission prices for all situations across the NEM, and for every year into the future, would result in inefficient transmission pricing outcomes and would not enhance the achievement of the National Electricity Objective. Issues which arise with an earlier mandated date include:

- TNSPs in some jurisdictions do not have access to the 'overs' and 'unders' revenue recovery mechanism in the Rules, and therefore need to be able to calculate their cost allocations and revenue exactly, using information which is not finalised until late April.
- Creation of additional impediments to the introduction of more national transmission pricing arrangements.
- Larger year to year 'overs' and 'unders' adjustments with an associated shift of revenue recovery from cost reflective pricing structures to non-cost reflective revenue recovery mechanisms. This reduces the efficiency of transmission price signals and introduces unnecessary price distortions with implications for reduced allocative efficiency.
- Based on the experiences in other NEM jurisdictions the issues raised by EnergyAustralia may be more effectively addressed via changes to the distribution pricing arrangements to operate within NSW.

These issues are discussed in more detail in the sections two to five below.

An earlier publication date should not be mandated but open to negotiation between TNSPs and their customers including DNSPs, end use customers, and generators.

Section six of this submission explains the significant steps that would be required to enable TNSPs to publish prices at an earlier date than the current deadline of 15 May. It then explains in more detail why mandating an earlier date for every TNSP and for every year of a regulatory control period results in inefficient outcomes and undermines the achievement of the National Electricity Objective.

2. Impediments to adjusting TNSP revenue from Year to Year

The pricing provisions in the NER allow for the under/over recovery of revenue to be adjusted for in the following pricing year only in the non-locational TUOS charges. Clause 6A.23.3 (c) (2) states:

(2) the remainder of the *ASRR* (the **pre-adjusted non-locational component**) is to be adjusted:

(i) by subtracting the amount (if any) referred to in paragraph (e);

(ii) by subtracting or adding any remaining *settlements residue* (not being *settlements residue* referred to in sub paragraph (1) but including the portion of *settlements residue* due to *intraregional loss factors*) which is expected to be distributed or recovered (as the case may be) to or from the *Transmission Network Service Provider* in accordance with clause 3.6.5(a);

(iii) for any *over-recovery amount* or *under-recovery amount*; [emphasis added]

(iv) for any amount arising as a result of the application of clause 6A.23.4(h) and (i); and

(v) for any amount arising as a result of the application of prudent discounts in clause 6A.26.1(d)-(g),

However, Victorian TNSP, SP AusNet, does not, and has no power to, set or recover TUOS in Victoria under the Jurisdictional Arrangements (this function rests with VENCorp (Clause 9.8.4C(e)). As such, the company has no access to an overs/ unders recovery mechanism for its revenue cap.

As a result, it is important that SP AusNet finalises its cost allocations and revenue calculations exactly where possible. The information that SP AusNet uses to achieve this is typically not able to be finalised until late April each year.

Therefore, any move to require an earlier publication date leaves some TNSPs potentially unable to recover their revenue (it should be noted that there are at least two other TNSPs in Victoria that also do not directly recover their TUOS).

The EnergyAustralia proposal creates this situation and so does not meet the National Electricity Objective or requirements in the National Electricity Law related to ensuring the regulated network businesses have a reasonable opportunity to recover the efficient cost of meeting regulatory obligations.

3. Proposal Undermines National Transmission Pricing

In its report to the Ministerial Council on energy the AEMC recommended:

> *"That the MCE requests the AEMC to conduct further analysis and consultation on the possible approaches for a formal arrangement for inter-regional transmission charging."*

The AEMC's discussion on this matter left no doubt that the AEMC saw the development of interregional transmission pricing as an important issue. However, Grid Australia considers that the EnergyAustralia proposal to mandate the earlier publication of transmission prices in every region of the NEM is a potential barrier to the eventual implementation of these arrangements. This section of the submission explains this in more detail.

3.1 The AEMC's Commitment to National Transmission Pricing

In coming to its recommendation in support of a move to National Transmission Pricing the AEMC stated that it:

> *"remains of the view that the current arrangement [of regional transmission pricing] represents a weakness in the regulatory framework that should be addressed, and one which is directly relevant to the NTP and the RIT-T. There are two potential problems:*
>
> *First, the **risk of sub-optimal investment plans**. Based on a strict economic analysis, an individual TNSP should be indifferent between projects that benefit consumers in its jurisdiction and projects that benefit consumers in another jurisdiction. There is no explicit difference in the revenue treatment of such investments. However, there might be 'softer' influences on TNSP behaviour, if particular investments impose costs but confer no benefits on local consumers.*
>
> *Second, the **dilution of cost-reflective price signals** to users of the transmission network. This is more clear-cut. The constrained ability to levy transmission charges across jurisdictional boundaries represents a direct barrier to attaining cost-reflective charges. Cost-reflective charges are important because they have the potential to promote efficient decision-making by market participants.*
>
> *The absence of an effective regime for inter-regional charging also has distributional impacts which might be considered to be inequitable, i.e., consumers in one region paying higher electricity bills to fund network investment which benefits consumers in another region. While these are less directly relevant from the strict perspective of economic efficiency, they might be relevant considerations in the wider context of regulatory consistency and stability. It should be noted that the size of these transfers between classes of consumers under the current regime might be expected to be increasing over time as the NEM, in general, becomes more inter-connected.*
>
> *The Commission considers that the implementation of a formal and transparent inter-regional transmission charging arrangement is essential to the development of a national and co-ordinated transmission grid. ERIG reached a similar conclusion stating in its final report that the development of an efficient and robust inter-jurisdictional TUOS payment system will be necessary as the development of the transmission grid takes on a more national focus, especially with the increase likelihood of future interconnection needed to support the development of a efficient and strategic grid."*

In summary, the AEMC has clearly concluded, presumably in the context of achieving the National Electricity Objective, that there are potentially important benefits to be derived from moving to a more national approach to transmission pricing. However, as explained below, the proposal to mandate an earlier publication date for transmission prices is likely to impede the ultimate implementation of this framework.

3.2 Why Proposal is Inconsistent with the Implementation of National Transmission Pricing

As explained in more detail in Section 6 of this submission, the implementation of transmission pricing across a number of TNSPs within a region requires one body to co-ordinate the setting of transmission prices in that region. That co-ordinating body is reliant on the other TNSPs in the region to provide a significant amount of information in time for the transmission price setting process to be carried out each year.

While the choice of the interregional transmission charging arrangements is yet to be determined, at least some of the options canvassed by the AEMC would require a national co-ordination process potentially an 'order of magnitude' greater than the current co-ordination within some of the NEM regions. For example, the AEMC's Option 2 contemplates the costs of new investment in assets to enhance the interconnected network being shared between all TNSPs in the NEM. Option 4 goes further and contemplates 'pooling' the regulated revenue allowances of all TNSPs with revenues being recovered through a single, NEM-wide charging methodology.

As a result the co-ordinating body under either of these options is likely to face challenges meeting the current mandated date of 15 May each year, let alone any earlier date proposed by EnergyAustralia. As such it would appear that the EnergyAustralia's proposal is likely to be inconsistent with the smooth implementation of at least two of the AEMC's options for national transmission pricing.

4. Proposal is Likely to Result in Inefficient Transmission Prices

Where transmission prices, for one reason or another, result in a mismatch of revenue received by a TNSP and the Maximum Allowable Revenue in a given year the transmission pricing principles in the Rules allow for 'unders' and 'overs' adjustments from one year to the next[1]. These adjustments occur in the non-locational transmission charges. Provided they are relatively small the impact on the adequacy of locational price signals is insignificant.

The current publication date of 15 May each year allows TNSPs to set prices with the best possible information across a range of input data each year. Section 6 of this submission explains much of the input data required to facilitate the setting of transmission prices accurately. To the extent that the accuracy of this data is compromised by the need to publish transmission prices at an earlier date the level of 'overs' and 'unders' tends to become more volatile.

In the event that more significant 'overs' and 'unders' adjustments result because of inaccurate price setting then distortions to the locational price signal increase as

[1] As noted in Section 2, this under and overs mechanism does not operate in Victoria.

relatively more is recovered from the non-locational charges in a given year. This reduces the allocative efficiency benefits of transmission pricing arrangements.

5. Experiences in Other NEM Regions Suggest Better Alternatives to Resolving the Issues Raised

Grid Australia believes that many of the issues raised by EnergyAustralia can be better addressed by adopting alternative approaches to distribution price setting which have been operating relatively smoothly in other NEM regions for many years. In this regard it is helpful to look more closely at each of the Victorian and South Australian regions in turn.

5.1 The Victorian Experience

It is interesting to note that most of the issues raised by EnergyAustralia appear to have been handled relatively smoothly in Victoria for 8 years where Distribution Businesses are required to price with considerable uncertainty regarding their transmission charges for 6 months of the calendar pricing year.

EnergyAustralia also acknowledges that its proposed solution would not address the issue nationally as the five Distribution businesses in Victoria price on a calendar year basis. This means that if the Victorian Distributors made the same arguments as EnergyAustralia they would want transmission prices set on calendar year basis and published by October.

This strongly suggests that the issues raised by EnergyAustralia are better addressed by Rule changes which introduce workable and uniform distribution business pricing arrangements and timelines while leaving the TNSP arrangements, which already work well, unchanged.

5.2 Lessons from South Australia

As highlighted in the EnergyAustralia Rule change proposal, the timing issue for DNSP's arises from the incorporation into Chapter 6 of the specific timetable for the provision of a *pricing proposal* previously applied to EnergyAustralia by IPART without reference to the timing for transmission pricing publication in Chapter 6A and, previously, Chapter 6.

While it is true to say that the majority of DNSP's establish prices on a financial year basis this statement seeks to imply that the timetable incorporated into the Rules is the minimum required for the DNSP's to provide a *pricing proposal* to the AER and for the AER to approve the same. Taking the South Australian jurisdiction as an example it is clear that this is not the case.

Clauses 2.2.2 and 3.2.2 of the 2005-2010 Electricity Distribution Price Determination Part B (EDPDB) published by the Essential Services Commission of South Australia (ESCOSA) in respect of distribution prices to be charged by ETSA Utilities state that a statement equivalent in form to the *pricing proposal* must be given to ESCOSA at least 40 business days and not more than 60 business days before the start of the regulatory year, or such other date as agreed by ESCOSA. The minimum requirement of 40 business days is around 5 May which is similar to the requirements of Clause 6.11.2 of the Rules.

Grid Australia understands that, in practice, this timeframe has been achieved by ETSA Utilities making an initial proposal within the timeframe required using draft pricing from the TNSP and subsequently making an amended proposal when the final TNSP prices are published. This affords ESCOSA the time required to substantially assess the compliance of the proposal with the principles of the pricing provisions of the EDPDB prior to the receipt of the amended proposal which reflects the changes to transmission prices brought about by the final version of the prices published by the TNSP.

Grid Australia proposes that, based on the South Australian experience, the AEMC could address EnergyAustralia's concerns by reviewing the relevant provisions of Chapter 6. The objective of this review would be to provide the option for DNSP's to submit *pricing proposals* based on draft transmission prices with the ability to submit amended *pricing proposals* based on final prices published by TNSP's by 15 May each year.

6. Practicality of Earlier Publication of Transmission Prices

To produce transmission prices each year TNSPs require the timely provision of key input data. If this data is not available on time TNSPs either cannot produce Rules compliant transmission prices, or are required to use estimates of the absent data with implications for balancing adjustments that need to be made in subsequent years.

Examples of the data required for TNSPs to produce prices include:

- a clearly defined transmission price setting Rules and/or an approved Transmission Pricing Methodology;
- the Maximum Allowed Revenue (MAR) to apply in the following year, including a final revenue cap decision and/or the relevant change in Consumer Price Index from one year to the next;
- adjustments to the MAR such as service incentive payments, approved 'pass throughs' and the incorporation of contingent project adjustments;
- the value of settlement residue auction proceeds to be offset against transmission prices for the upcoming financial year;
- information from other TNSPs required by the co-ordinating TNSP to carry out the price setting process;
- the most recent actual and forecast energy consumption and maximum demand data at each connection point; and
- updated network configuration data to reflect recent and expected transmission augmentations and new connection points with DNSPs, customers and generators.

Each of these requirements is explained in more detail in the following sections of this submission.

6.1 The Availability of Price Setting Rules

In accordance with the current Rules the AER is not required to approve the Transmission Pricing Methodologies to be used by EnergyAustralia, TransGrid, or Transend until 30 April 2009. This is clearly too late to meet EnergyAustralia's revised mandated publication date of 1 March in 2009. Accordingly, assuming the AEMC is satisfied that EnergyAustralia's proposal enhances the National Electricity Objective the Rules would also need to clearly set out that transmission prices would be set on the basis of the pricing methodology in place prior to the AER's approval of the proposed Transmission Pricing Methodology.

As the regulatory cycle rolls forward in each region the relevant co-ordinating TNSPs will confront this issue in turn.

6.2 Establishing the Relevant Maximum Allowed Revenue Each Year

According to Clause 6A.22.1 of the Rules the Maximum Allowed Revenue (MAR) is to be used as the basis for setting transmission prices each year. As such this needs to be determined before prices can be calculated and published. The MAR is the result of a revenue cap decision.

For TransGrid, EnergyAustralia, and Transend, in accordance with the current National Electricity Rules, the AER is not required to finalise its decision on MAR until 30 April 2009. In future years other TNSPs will face a similar timing problem as the revenue setting process moves progressively from one region to another.

Therefore, in order to meet the revised publication date proposed by EnergyAustralia, the Rules would need to be amended to allow TNSPs to base transmission prices on the AER's draft revenue cap decision during the year in which a revenue cap decision is made.

6.3 Consumer Price Index Data

Consumer Price Index (CPI) adjustments to MAR from one year to the next, in accordance with the CPI-X formula applied to TNSP revenue cap decisions, require the most recently available twelve months of published CPI data. The current transmission pricing date of 15 May each year allows TNSPs to apply the March quarter CPI following its publication in late April.

To meet EnergyAustralia's proposed new publication date TNSPs would need to either use the December to December quarter CPI movements, or substitute a forecast for the March quarter CPI movement in lieu of the actual result. It should be noted that the December to December quarter CPI movements are effectively 6 months out of date by the time they could be applied for transmission pricing purposes.

6.4 Information on Adjustments Required to the Maximum Allowed Revenue

Clause 6A.22.1 requires transmission prices to be based on the MAR as adjusted in accordance with clause 6A.3.2. Clause 6A.3.2 in turn requires the MAR to be adjusted for:

- re-opening of a revenue determinations for capital expenditure (6A.7.1);
- adjustments to MAR for a network support pass through (6A.7.2);
- adjustments to MAR for cost pass through (6A.7.3);
- adjustments to MAR for the service target performance incentive scheme (6A.7.4); and/or
- adjustments to MAR as a result of the acceptance of a contingent project in a revenue determination (6A.8).

To meet EnergyAustralia's revised publication date for transmission prices each year the Rules would need to expressly recognise that the impact of each of these adjustments may not be able to be accommodated in the year in which they occur. For example, the Rules may need to be amended to require the AER to finalise incentive payments by the end of January each year – it is not obvious that this is practical under the current calendar year basis for reporting mandated by the Rules.

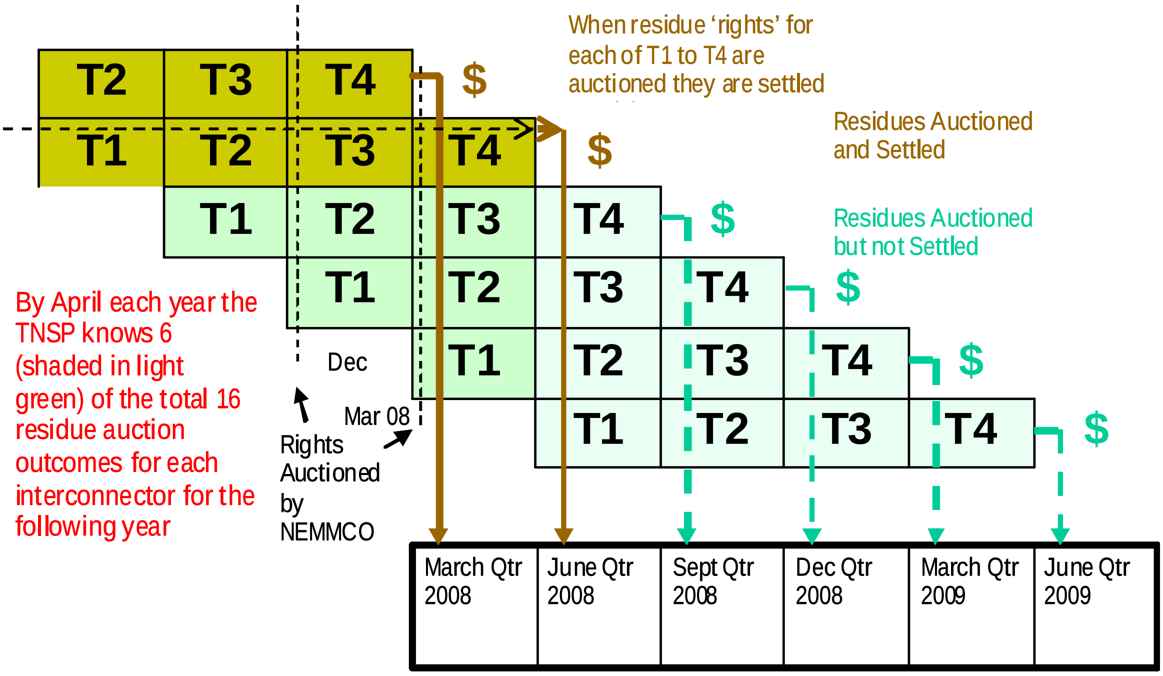
Alternatively, or as well, the Rules could expressly provide for resulting adjustments to MAR to be carried over to a subsequent year. Such adjustments would also need to include compensation for foregone regulated returns due to the delay in revenue recovery. For example, a network support pass through payment may not be approved by the AER until after March in a given year. Under EnergyAustralia's proposal this adjustment could not be included in the calculation of MAR until nearly 12 months later and TNSPs would forego revenue entitlements for that time.

6.5 Adjusting for Settlement Residue Auction Proceeds

To set transmission prices each year TNSPs require information on the future cash flows from settlement residue auction proceeds. The Rules require these proceeds to be returned to customers as reduced transmission charges each year. Generally, TNSPs have attempted to set prices to match the expected level of residue auction proceeds at the time they are received. This results in these proceeds being returned to customers broadly in line with when they are received by the TNSP.

Settlement residue auction proceeds can be material in some regions (e.g. more than 20% of the transmission revenue cap) and can vary significantly from one year to the next. However, the NEMMCO auction process currently provides a good indication of future cash flows to TNSPs from these auctions in advance. This is explained further in Figure 1 below.

Figure 1 – Settlement Residue Auction Outcomes Information for Transmission Price Setting Purposes



Significantly, the information available from the March quarter auction results each year assists greatly in achieving the required matching of settlement residue auction receipts with refunds to customers via the transmission pricing process. The earliest that TNSPs could publish prices that make use of this information each year is early April. If the Rules were amended to require publication before this time then adjustments to transmission prices to refund residues would be far less accurate.

6.6 Information Required by the Co-ordinating TNSP

In some regions there is more than one registered NEM TNSP. For example there is VENCorp, SP AusNet and Murraylink in Victoria, ElectraNet and Murraylink in South Australia, and TransGrid, EnergyAustralia, Directlink, and Country Energy in NSW. In these circumstances the Rules provide for the appointment of a co-ordinating TNSP to develop transmission prices across the region as a whole.

The co-ordinating TNSP is reliant on the timely provision of information from the other TNSPs in order to produce Rules compliant transmission prices. The current deadline of 15 May for the publication of transmission prices has been factored into terms and conditions for the timely provision of information to the coordinating TNSP in agreements between the parties. These arrangements do not provide for the earlier publication date proposed by EnergyAustralia.

To allow the co-ordinating TNSP to meet its deadline for publication some or all of the following information is required from other TNSPs, typically at least two months before the publication date:

- the other TNSP's AARR including their performance incentive adjustments;

- details of the other TNSP's transmission network data including transmission lines and connection points, shared network and exit asset costs;
- metering data for of the other TNSP's connection points;
- the other TNSP's non-asset related common service costs;
- the other TNSP's over or under-collection in previous years;
- information on the other TNSP's customers who have chosen to have the adjusted non-locational component of the prescribed TUOS services and the prescribed common transmission services charges billed on the basis of a nominated maximum demand; and
- information on customers with TUOS discounts from of the other TNSP's, sufficient to allow adjustment for the shortfall in revenue.

The co-ordinating TNSP usually applies the 2% change limit to the locational component of prescribed TUOS services for of the other TNSPs' connection points in the same manner as applying to the co-ordinating TNSP's connection points. If of the other TNSPs want any change to this, they will need to advise the co-ordinating TNSP and, if necessary, provide relevant data.

6.7 Information on Energy Consumption, Maximum Demand and Network Configuration

The more recent the actual and forecast energy consumption and maximum demand data for each connection point that is used in setting transmission prices the more likely that over or under collection of MAR will be minimised each year. This also applies to information on the network configuration which is continually evolving to reflect recent and expected transmission augmentations and new connection points with DNSPs, customers and generators. Clearly, the later that transmission prices are published the more accurately they reflect this information. The EnergyAustralia proposal, if implemented, would tend to reduce the accuracy of the transmission prices.

6.8 The Importance and Timing Requirements for this Information Varies from Region to Region

In the absence of adjustments to the Rules to ensure that the timing of each of the above pricing input information requirements line up with the new date proposed by EnergyAustralia it will simply not be possible for TNSPs to complete the extensive and complex pricing computations required by the new date.

In addition, the importance of timing of input data varies across the NEM depending on the circumstances prevailing in any given jurisdiction. For example, in NSW and South Australia information on the outcomes of settlement residue auctions available from NEMMCO at the end of March is very important because of the relatively significant impact of auction proceeds on transmission prices in those jurisdictions.

Furthermore, in some jurisdictions (e.g. NSW and Tasmania) transmission revenue cap applications are currently in progress. For this reason the MAR to be used in pricing calculations and the relevant Transmission Pricing Methodologies will not be settled until the end of April 2009. In later years this problem will move to other jurisdictions as each TNSP's regulatory control period ends.

In summary, EnergyAustralia's proposed 'one size fits all' approach to setting an earlier mandated date for publishing transmission prices across the entire NEM introduces a suite of timing issues which vary from one region to another.

Grid Australia considers that this approach undermines and does not enhance the achievement of the National Electricity Objective. Grid Australia also notes that some of EnergyAustralia's specific issues may be able to be dealt with bilaterally between itself and TransGrid without the need to impose the proposed 'one size fits all' approach to the entire NEM.

7. Summary

Grid Australia does not support changing the 15 May date specified in the Rules for publication of annual transmission prices. Indeed, mandating an earlier date than 15 May for the publication of transmission prices for all situations across the NEM, and for every year into the future, would result in inefficient transmission pricing outcomes and would not enhance the achievement of the National Electricity Objective.

An earlier publication date should not be mandated, but open to negotiation between TNSPs and their customers including DNSPs, end use customers, and generators. As noted in Section 6 of this submission the changes to the Rules required enabling this to occur, without unduly compromising pricing accuracy, would be extensive with benefits that vary from one region to another and from one year to another depending on local circumstances. It is not clear that, even with extensive changes to the Rules, that EnergyAustralia's new publication date can be achieved in every instance.

In addition, mandating an earlier publication date does not appear to be consistent with the AEMC's assessment of the need for the introduction of a more national approach to transmission pricing. At least two of the options canvassed by the AEMC require significant timely provision of information by each NEM TNSP to the body co-ordinating the setting of transmission prices each year. This is expected to prove challenging even with the current publication date of 15 May, let alone with the earlier date proposed by EnergyAustralia.

Finally, EnergyAustralia's proposal tends to undermine the accuracy of the resulting locational transmission price signals reducing rather than enhancing allocative efficiency and the achievement of the National Electricity Objective.

For these reasons Grid Australia proposes that the AEMC considers the experiences in Victoria and South Australia. These suggest that the issues raised by EnergyAustralia could be more easily and efficiently be addressed by changes to Chapter 6 of the Rules which introduce workable and uniform distribution business pricing arrangements and timelines. In any event, the case for mandating a 'one size fits all' earlier date for transmission price publication in all regions of the NEM and in every year, regardless of the regulatory processes underway at the time, has not been made in terms of enhancing the National Electricity Objective.