

Cost Allocation Arrangements for Transmission Services

Supplementary Response to NGF Rule
Change Proposal

9 July 2008

Further Submission of Grid Australia

1. Introduction and outline of Grid Australia's first submission

- 1.1 Grid Australia lodged a submission with the AEMC on 2 May 2008 (**first submission**) in response to the Rule change proposal submitted by the National Generators' Forum (NGF) in respect of transmission entry and exit charges.
- 1.2 Set out below is a brief outline of Grid Australia's first submission.
- 1.3 Grid Australia commented on each of the 4 aspects of the NGF's Rule change proposal. Namely amending:
 - (a) the grandfathering provisions in clause 11.6.11 dealing with *entry services* or *exit services* which are deemed to be *prescribed transmission services*;
 - (b) the cost allocation provisions which are to apply to *transmission services* which are grandfathered as *prescribed transmission services* under clause 11.6.11;
 - (c) the circumstances in which an asset can be removed from the RAB; and
 - (d) the operation of the *Transmission Ring-Fencing Guidelines*.
- 1.4 Grid Australia indicated that it considered that the drafting of the proposed Rule changes relating to the first three aspects of the NGF's Rule change could be improved upon in a number of respects.
- 1.5 Grid Australia initially indicated that it supported the NGF's proposal relating to the *Transmission Ring-Fencing Guidelines*. However, since making its first submission, Grid Australia has given further consideration to this issue and now considers that changes to the proposed drafting in relation to this issue would improve the proposal.
- 1.6 Grid Australia also explained that while it agreed with the NGF that the grandfathering provisions in clause 11.6.11 of the Rules were uncertain in their meaning (and therefore are deficient and should be amended) Grid Australia considered that the proposal put by the NGF was not the only or preferred means of dealing with the issues of concern identified by the NGF.
- 1.7 Further, the NGF's proposal did not in Grid Australia's view provide a solution to the other broader issues which were identified by Grid Australia in its first submission concerning the operation of existing clause 11.6.11.
- 1.8 In particular, Grid Australia submitted that there was a clear and practical need for the AEMC to examine the intended operation of clause 11.6.11 more broadly.

1.9 Grid Australia noted that if the AEMC concluded that it could not examine these broader issues when considering the NGF Rule change proposal, Grid Australia would need to consider lodging its own Rule change proposal.

2. **Scope of further submission concerning alternative proposal**

2.1 Grid Australia understands that:

- (a) alternatives to the NGF's rule change proposal can be considered by the AEMC within the scope of its consideration of that rule change proposal provided the alternatives relate to the topics or issues raised in the NGF's rule change proposal; and
- (b) there is no requirement for Grid Australia at this stage to itself institute a separate rule change proposal.

2.2 Based on that understanding, Grid Australia has developed an alternative proposal. Grid Australia now wishes to submit its alternative drafting for formal consideration by the AEMC. A copy of that alternative drafting is attached as Annexure 1.

2.3 Grid Australia has consulted with the NGF in relation to the drafting of its alternative proposal. As a result, it modified some aspects of its original proposal. Grid Australia has also tried (wherever possible) to address both the issues raised by the NGF in its Rule change proposal and the additional issues raised by Grid Australia in its first submission.

2.4 In this further submission Grid Australia:

- (a) outlines its alternative drafting;
- (b) explains the principles and rationale which underlie the proposal;
- (c) explains how the Grid Australia proposal differs from the NGF proposal; and
- (d) gives a brief explanation concerning the drafting used in the proposal.

3. **A more preferable Rule**

3.1 The NGF's Rule change proposal is classified as a 'market initiated proposed Rule'. The AEMC may make a Rule that is different (including materially different) from a market initiated proposed Rule.

- 3.2 Under the National Electricity Law an alternative Rule is called a 'more preferable Rule'¹.
- 3.3 Grid Australia notes that the AEMC may make a more preferable Rule if the AEMC is satisfied that the more preferable Rule will or is likely to better contribute to the achievement of the national electricity objective.
- 3.4 It is only necessary that the more preferable Rule relate to the issue or issues that were raised by the market initiated proposed Rule.
- 3.5 In this further submission Grid Australia outlines what it considers to be a more preferable Rule, and requests that the AEMC give consideration to making a Rule in those terms as a more preferable Rule instead of accepting the NGF's initial Rule change proposal.
- 3.6 Grid Australia's submission is that the AEMC should be satisfied that the alternative drafting submitted by Grid Australia will or is likely to better contribute to the achievement of the national electricity objective when compared to the NGF's initial Rule change proposal, and therefore comparatively it is a more preferable Rule. The reasons why this is so are explained below.
- 3.7 Grid Australia also submits that the AEMC should be satisfied that making a Rule in the alternative terms proposed by Grid Australia will also satisfy the Rule making tests² (i.e. the alternative Rule will or is likely to contribute to the achievement of the national electricity objective).

4. **Promotion of achievement of national electricity objective**

- 4.1 The national electricity objective³ 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.
- 4.2 Grid Australia considers that this objective as a whole, and individual elements of the objective, are likely to be promoted by its alternative drafting.

¹ Section 91A National Electricity Law.

² Section 88 National Electricity Law.

³ Section 7 National Electricity Law.

- 4.3 Grid Australia's alternative drafting affects the same parties as those identified in the NGF's addendum to its proposal in support of its Rule change proposal (submitted to the AEMC by letter dated 18 January 2008).
- 4.4 Grid Australia submits that its alternative proposal is likely to promote the achievement of the national electricity objective, both absolutely and in comparative terms, because its proposal:
- (a) increases regulatory certainty in that it:
 - (i) reduces the uncertainty of meaning that presently exists in relation to clause 11.6.11 of the Rules;
 - (ii) contains a clear test for when a service is deemed to be a *prescribed transmission service* under clause 11.6.11;
 - (iii) contains a clear test for when a service ceases to be deemed to be such a *prescribed transmission service* for the purposes of clause 11.6.11; and
 - (iv) defines the only circumstances in which a service is to be taken to be a *negotiated transmission service* for the purposes of the Rules;
 - (b) through the reduction of the regulatory uncertainty of existing clause 11.6.11, the proposal enhances transparency and thereby promotes good regulatory practice;
 - (c) will reduce regulatory complexity in relation to the treatment of assets that replace *transmission system* assets which are used to provide *connection services* which are deemed to be *prescribed transmission services* under clause 11.6.11 (This will also potentially reduce the transaction costs (compared to the costs likely to be incurred if the Rule change is not made) of all parties associated with negotiating and administering the *connection agreements* between *TNSPs* and *Transmission Network Users*); and
 - (d) avoids the potential for 'price shock' in a similar manner to that identified by the NGF in its proposal.
- 4.5 Grid Australia submits that the increase in regulatory certainty, and the corresponding reduction in regulatory complexity, inherent in its alternative drafting should therefore be regarded as benefiting both *Generators* and *Transmission Customers* in their investment decisions, and hence will increase productive and allocative efficiency ultimately for the benefit of all consumers of electricity.

- 4.6 Further in relation to those parts of Grid Australia’s proposal that concern the assets which are to be attributed to *connection services* grandfathered as *prescribed transmission services* under clause 11.6.11, given that clause 11.6.11 is concerned with *connection services* which are already in place or are relevantly committed, the proposal is consistent with considerations of allocative efficiency relating to the provision of *connection services*.
- 4.7 In this context allocative efficiency means the dimension of economic efficiency which describes the benefits from production and consumption decisions being based on prices linked to the costs involved so that optimal provision and use of services occurs.
- 4.8 A provision limiting the assets which are to be attributed to the deemed services is consistent with considerations relating to allocative efficiency, and therefore consistent with the national electricity objective, because it will not distort past investment decisions or be relevant to future investment decisions as it will not apply to them.
- 4.9 It will thus not impact on dynamic efficiency – meaning maximising ongoing productive and allocative efficiency over time - and therefore will not affect adversely the promotion of efficient longer term investment decisions relating to electricity services.
- 4.10 Grid Australia therefore submits that its alternative drafting is consistent with, and will promote, the achievement of the national electricity objective.

5. **Principles underlying drafting of proposed clause 11.6.11**

- 5.1 In this further submission Grid Australia seeks to outline clearly the principles which it submits should underpin any redrafting of clause 11.6.11 and other related clauses of the Rules.
- 5.2 Grid Australia submits that clause 11.6.11 should reflect the principles that:
- (a) *negotiated transmission services* can only arise through a process of negotiation; and
 - (b) *negotiated transmission services* cannot be deemed to exist between a *Transmission Network Service Provider* and *Transmission Network User* under the Rules in the absence of an actual agreement between those parties.
- 5.3 Grid Australia submits that those principles are already implicit in the Rules, but to avoid any doubt should be made explicit through clarification.

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- 5.4 Since clause 11.6.11 creates a deemed position, which would otherwise not exist under the Rules, Grid Australia considers that clause 11.6.11 should be carefully drafted to make it clear that if the deeming created by clause 11.6.11 in respect of the provision of a *prescribed transmission service* ends it is not replaced by another deeming which would deem any continued provision of the service to be a *negotiated transmission service*.
- 5.5 Grid Australia considers that one of the deficiencies of the existing clause 11.6.11 is that it could be read as allowing that possibility.
- 5.6 Grid Australia also submits that the drafting of clause 11.6.11 should reflect the principle that *connection services* can be provided at a *connection point* on a 'divisible' basis, and hence multiple or separate services could be provided. This is elaborated on separately below.
- 5.7 Grid Australia contends that recognition of this principle would assist in putting appropriate limits on the continued provision of *connection services* as grandfathered *prescribed transmission services* under clause 11.6.11.
- 5.8 It would assist, for example, in providing a solution to the problems identified by Grid Australia in its first submission about how a service should be classified under clause 11.6.11 where there is a change in the *transmission system* assets used to provide the service, or some change in the service itself being provided over time.
6. **Clause 6A.19.2(6) cost allocation principle – Transmission Ring-Fencing Guidelines**
- 6.1 The *Cost Allocation Principles* include the principle in clause 6A.19.2(6) that:
- ‘the principles, policies and approach used to allocate costs must be consistent with the *Transmission Ring-Fencing Guidelines*’
- 6.2 The NGF’s proposal is to delete this principle in its entirety. Grid Australia considers that it would be preferable to retain the principle and deal with the issue identified by the NGF through other changes to clause 6A.21.2.
- 6.3 The *Cost Allocation Principle* in sub-clause (6) is a fundamental component of Chapter 6A. Therefore it would be preferable to amend clause 6A.21.2 to make it clear that the *Transmission Ring-Fencing Guidelines* cannot require allocation of costs as between *prescribed transmission services* and *negotiated transmission services*, or between categories of *prescribed transmission services*, in a manner which is inconsistent with the *Cost Allocation Principles*.
- 6.4 The general approach taken in Chapter 6A is that 'Principles' stand at a higher level than 'Guidelines'. Therefore the latter should not be able to modify the former as is presently possible under clause 6A.21.2.

6.5 Grid Australia can see no reason why the AER, through the making of *Transmission Ring-Fencing Guidelines*, should be able to alter the cost allocation approach which Chapter 6A has established.

7. Removal of assets from regulatory asset base – clause S6A.2.3

7.1 It is considered that the NGF’s proposed amendment is unnecessary and therefore is not included in Grid Australia’s proposal.

7.2 The NGF proposed to introduce a new paragraph (ab) to clause S6A.2.3, which prevents the removal of the value of an asset from the RAB during a regulatory reset in circumstances where:

- (a) there has been a reconfiguration of the *transmission system*; and
- (b) that reconfiguration causes relevant conditions for removal of an asset from the RAB in clause S6A.2.3(a) to be met; and
- (c) the affected *Transmission Network User(s)* have not requested or consented to the reconfiguration or have not unreasonably refused or failed to consent to the removal of an asset from the RAB.

7.3 Under Grid Australia’s alternative drafting it is clear that a *transmission system* reconfiguration:

- (a) cannot trigger a change in classification under clause 11.6.11 of a *connection service* being provided as a *prescribed transmission service*; and
- (b) cannot result in an increase in the *transmission system* assets which are to be regarded as attributable to the provision of a *connection service* which is a *prescribed transmission service* under clause 11.6.11.

7.4 Therefore a *transmission system* reconfiguration will not give rise to a situation where assets could be removed from the RAB on the basis that a *prescribed transmission service* under clause 11.6.11 is no longer being provided.

7.5 Grid Australia considers that it follows that the existing provisions in clause S6A.2.3 regarding the circumstances in which assets may be removed from the RAB of a *Transmission Network Service Provider* are adequate **if** the following approach is adopted in clause 11.6.11.

8. Overview of approach to clause 11.6.11 in Grid Australia’s proposal

8.1 Grid Australia’s proposal involves largely re-writing existing clause 11.6.11, and replacing it with a simpler structure to that proposed by the NGF.

- 8.2 In general terms, this proposal:
- (a) firstly, aims to ‘grandfather’ as *prescribed transmission services, connection services* (called ‘prescribed connection services’) provided by a defined group of *transmission system* assets (called ‘eligible assets’); and
 - (b) secondly, deals with how the general provisions in Chapter 6A apply to prescribed connection services.

8.3 In particular, proposed clause 11.6.11 does three things:

- (a) Sub-clause (a) contains definitions, and describes ‘prescribed connection services’.
- (b) Sub-clause (b) is the operative provision. It deems ‘prescribed connection services’ to be *prescribed transmission services* for the purposes of Chapter 6A.
- (c) Sub-clause (c) deals with how the general provisions in Chapter 6A apply to ‘prescribed connection services’ to achieve the same outcome as proposed by the NGF. Namely limiting the assets which can be attributed to prescribed connection services, and substituting a requirement for allocating any shortfall in costs to another sub-category of *prescribed transmission services*.

9. Use of definitions

- 9.1 The proposed clause 11.6.11 picks up and uses the existing definitions (found in clause 11.6.1) which are used only in Rule 11.6: i.e. the terms ‘commencement date’⁴ and ‘new Chapter 6A’.
- 9.2 It also contains 5 new definitions in clause 11.6.11(a): i.e. ‘existing asset’, ‘committed asset’, ‘replacement asset’, ‘eligible asset’, and ‘prescribed connection service’.
- 9.3 The new definitions have not at this stage been placed in alphabetical order because we think this makes it easier to understand the relationship between the new definitions.
- 9.4 The new definitions are not italicised (which reflects the practice adopted in Chapter 11 generally). In the *Rules* the only italicised terms are those defined in the Chapter 10 Glossary.

⁴ That is 16 November 2006.

10. **Underlying concept - *connection services* are divisible**

- 10.1 As noted in paragraph 5 above, Grid Australia's proposal is based on the approach that *connection services* provided by a *Transmission Network Service Provider* to a *Transmission Network User* at a *connection point* should be regarded as 'divisible' services. That is, there can be a number of separate *connection services* provided at a *connection point* at the same time. These could be different *connection services* or additional *connection services*.
- 10.2 Therefore it should be possible to have, for example, a grandfathered *connection service* (i.e. a 'prescribed connection service' using our new definition) being provided at a *connection point* at the same time as another non-grandfathered *connection service* (i.e. a *connection service* which is either a *negotiated connection service* or a *non-regulated transmission service*) is being provided at the same *connection point* in addition to a prescribed connection service.
- 10.3 In order to shorten proposed clause 11.6.11, Grid Australia has not included a specific statement to the effect of this principle in its Rule change proposal. A 'for the avoidance of doubt' type interpretation clause which states this principle could of course be included if that was felt necessary.
- 10.4 In any event if the principle is accepted by the AEMC, Grid Australia submits that it would be useful if the AEMC were to confirm this underlying concept in its final Rule determination.

11. **Starting position for grandfathering**

- 11.1 The proposal adopts the same general starting point as the current provision.
- 11.2 That is, the 'grandfathering' relates to *connection services* provided by assets which were:
- (a) in the RAB of a *TNSP* as at 9 February 2006; or
 - (b) included within the forecast capital expenditure for a relevant *transmission system* described in the existing revenue determination in force as at 9 February 2006 and would have been included in the RAB of the *TNSP* if the relevant assets were committed to be constructed before the end of the *regulatory control period* for the existing revenue determination.
- 11.3 The proposal differs from the position under existing clause 11.6.11 (as it has been interpreted by the AER) in that it will allow an existing *connection service* to remain as a prescribed connection service even if some or all of the existing assets or committed assets which are used to provide the prescribed connection service are later replaced. The rationale for this is outlined below.

12. **Need for grandfathering services by reference to assets**

- 12.1 The proposal is based on the approach that it is necessary, as a matter of practicality, to ‘grandfather’ *connection services* for the purpose of new Chapter 6A by reference to the assets which were used, or were committed to be used, at the relevant date to provide the services which are being ‘grandfathered’.
- 12.2 Grid Australia considers that the identification of the services which are to be deemed to be *prescribed transmission services* under clause 11.6.11 cannot usefully occur without specification of the *transmission system* assets which are used to provide those services.
- 12.3 Grid Australia therefore considers that it is necessary to define those services by reference to the assets used to provide those services. It has therefore adopted that approach in the drafting of its alternative proposal.

13. **Existing assets**

- 13.1 This is a key definition. It adopts the same approach as under existing clause 11.6.11. ‘Existing assets’ are those which were in the RAB of a *TNSP* as at 9 February 2006.

14. **Committed assets**

- 14.1 The proposal in essence adopts the same approach to ‘committed assets’ as is adopted under existing clause 11.6.11.
- 14.2 Committed assets are those which were committed to be constructed as at 9 February 2006. The proposal repeats the provision in existing clause 11.6.11(c) which enables an asset to be treated as committed only if satisfies the ‘committed project’ criteria of the *regulatory test* but clarifies that it is the version of the test in force as at 9 February 2006.
- 14.3 The definition of ‘committed asset’ is intended to clarify (for the avoidance of any doubt) that committed assets are those that, as at 9 February 2006, were committed to be constructed for the provision of *prescribed transmission services*. This clarification is provided by inclusion in the definition of ‘committed asset’ the requirement that the forecast capital expenditure for the committed project must have been included in a revenue determination of the *TNSP* in force at that date.

15. **Replacement assets**

- 15.1 Grid Australia’s proposal is to include in the definition of an ‘eligible asset’ a ‘replacement asset’ which is wholly and exclusively used after the commencement date by a *Transmission Network Service Provider* to continue providing a *connection service* to a *Transmission Network User* or group of *Transmission Network Users* at a *connection point*.
- 15.2 The rationale for this approach is separately discussed below.

- 15.3 A 'replacement asset' is one which replaces an 'existing asset' or 'committed asset' on or after 9 February 2006⁵, and includes successive replacements of assets over time.
- 15.4 The definition of 'replacement asset' would clearly cover a 'like for like' replacement (i.e. the replacement of an old 80 MVA *transformer* with a new 80 MVA *transformer*). It is also intended that the definition of 'replacement asset' should cover the situation where a 'like for like' replacement is not possible due to, for example, the fact that 80 MVA *transformers* are no longer available. In this case, the closest prudent alternative asset (e.g. a 100 MVA *transformer*) would be used to replace the old asset and would be treated as a 'replacement asset' even though it provides a higher capability than the old asset.
- 15.5 However, where a 'betterment' replacement occurs at the request of the *Transmission Network User* (i.e. where the relevant *Transmission Network User* takes the opportunity to request the *TNSP* to replace the old asset (the 80 MVA *transformer*) with a new asset with a higher capability (a 100 MVA *transformer*), it is appropriate that the higher capability requested by the *Transmission Network User* should be:
- (a) outside the concept of a 'replacement asset'; and
 - (b) dealt with as a request for a *negotiated transmission service* (i.e. the additional 20 MVA capability would be treated as a divisible *connection service/negotiated transmission service*).
- 15.6 A *TNSP's* expenditure on replacement of assets used to provide prescribed connection services (i.e. *connection services* which are deemed to be *prescribed transmission services* under clause 11.6.11) will be subject to the usual processes for assessment of the reasonableness and prudence of expenditure by the AER in accordance with the *revenue determination* procedures under Chapter 6A. Therefore the process will be controlled.
16. **Eligible assets**
- 16.1 The definition of 'eligible assets' is a key definition.
- 16.2 Prescribed connection services are limited to *connection services* provided using eligible assets only.
- 16.3 Eligible assets are a subset of the existing assets, committed assets and replacement assets and are defined according to whether they were used at the nominated time to provide *connection services*.

⁵ It is more appropriate to use this date than the 'commencement date' because some replacements may have occurred in the period from 9 February 2006 to 16 November 2006.

- 16.4 For existing assets the nominated time is immediately before 16 November 2006. For committed assets, it is when those assets are first commissioned after 9 February 2006. It is a ‘once only’ determination.
- 16.5 The definition then considers whether at that time the relevant asset was ‘wholly and exclusively’ used to provide *connection services*. If it was, the whole asset is an ‘eligible asset’.
- 16.6 The term ‘eligible asset’ is drafted so that if an asset ceases to be used to provide a *connection service* after the commencement date the asset will cease to be an eligible asset to the extent that it ceases to be used for that purpose.
- 16.7 Take for example, the situation of a *Generator connected to a network* via a radial line where a *Distribution Network Service Provider* later connects to the *transmission network* via the same radial line. In that situation it would not be appropriate to ‘lock in’ for all time the initial asset treatment of those *transmission system* assets (i.e. the eligible assets) regarded as being attributable to the prescribed connection service which continues to be provided to the *Generator*.

17. **Prescribed connection services**

- 17.1 Proposed clause 11.6.11 uses a new defined term ‘prescribed connection services’.
- 17.2 ‘Prescribed connection services’ are defined in terms of 3 criteria, all of which must continue to be established for the relevant *connection service* to remain as a ‘prescribed connection service’ (and hence a *prescribed transmission service* for the purposes of Chapter 6A).
- 17.3 The definition uses the term ‘to the extent that’. This is intended to reflect the fact that:
- (a) *connection services* are intended to be divisible; and
 - (b) it is possible that a prescribed connection service may be provided to a *Transmission Network User* at a *connection point* while at the same time an additional or different *connection service* (being a *negotiated transmission service*) is also being provided to that *Transmission Network User* at the same *connection point*.
- 17.4 In order for a *connection service* to be a ‘prescribed connection service’:
- (a) first, the *connection service* must be provided using eligible assets only;

- (b) secondly, the *connection service* must be provided under a *connection agreement* which was first entered into before 16 November 2006. It follows that if a *connection agreement* under which prescribed connection services are provided has a limited term, the ‘grandfathering’ of those prescribed connection services will end when the term of the *connection agreement* expires; and
- (c) thirdly, as with existing clause 11.6.11, the *connection service* must not otherwise fall within the ordinary definition of *prescribed transmission services*. Therefore, for example, *network to network connection services* fall outside clause 11.6.11.

18. **Provision of the service under a connection agreement first entered into before the commencement date**

18.1 Under Grid Australia’s proposal in order for a *connection service* to be a ‘prescribed connection service’ the service must continue to satisfy the requirement that the relevant service is:

‘being provided under a *connection agreement* which was first entered into before the commencement date’

18.2 This requirement is not currently found in clause 11.6.11. Grid Australia’s rationale for inclusion of the criterion in its proposal relates to what it understands to be the underlying intent of existing clause 11.6.11 (i.e. that the grandfathering created by the clause is intended to be transitional, and therefore must be capable of being brought to an end over time).

18.3 It is therefore desirable to include in a re-drafted clause 11.6.11 criteria which define clearly when the deeming created by that clause will end.

18.4 Defining a ‘prescribed connection service’ in terms of the *connection agreement* under which it is provided will assist in providing a clear test as to when a deemed *prescribed transmission service* under clause 11.6.11 will end.

18.5 The general approach taken by the AEMC in its Rule determination of 16 November 2006 was to define *connection services* as negotiable, recognising that a negotiable outcome is preferable to regulation for the achievement of the then applicable NEM objective.

18.6 Grid Australia considers that at the point where an existing *connection agreement* has terminated it is appropriate that any *connection services* provided thereafter no longer be regarded as deemed *prescribed transmission services* under clause 11.6.11. In that circumstance it is an appropriate policy position that the provision of any further *connection services* be negotiated, and occur, either as *negotiated transmission services* or where relevant as *non-regulated transmission services*.

19. **Clause 11.6.11(b) – Prescribed Transmission Services**

- 19.1 As noted above, proposed clause 11.6.11(b) is the operative provision.
- 19.2 It requires that references to *prescribed transmission services* in new Chapter 6A include ‘prescribed connection services’ as defined under the proposed new clause 11.6.11.
- 19.3 The second half of new clause 11.6.11(b) repeats existing clause 11.6.11(b) which provides that where a service is a *prescribed transmission service* by virtue of the operation of clause 11.6.11 that service is taken not to be a *negotiated transmission service*.

20. **Rationale for proposed treatment of replacement assets**

- 20.1 Grid Australia’s proposal is drafted on the basis that the replacement over time of assets which were in the RAB as at 9 February 2006, and which are used to provide services grandfathered as *prescribed transmission services* under clause 11.6.11 should not trigger the cessation of the grandfathering for that reason alone, if the service otherwise continues to satisfy the test of being a ‘prescribed connection service’.
- 20.2 This differs from the position under existing clause 11.6.11 as it has been interpreted by the AER. In its Rule determination of 16 November 2006⁶ the AEMC expressed the view, in the context of discussion of ongoing treatment of grandfathered prescribed connection services, that it would be appropriate that any replacement or reconfiguration of a connection asset grandfathered as providing *prescribed transmission services* in accordance with clause 11.6.11 should be treated as a ‘negotiated service asset’.
- 20.3 Grid Australia however submits that there exist good reasons (both policy reasons and practicality reasons) why asset replacements should not be treated in that way. Grid Australia therefore submits that the matter should receive further examination by the AEMC.
- 20.4 Grid Australia observes that its proposal about asset replacements is modest and strictly limited in scope.
- 20.5 Grid Australia’s proposal in relation to replacement assets is limited to those replacement assets which are ‘wholly and exclusively used’ to provide a *connection service*. That will therefore exclude any asset which replaces another asset if the replacement serves multiple purposes. Grid Australia’s proposal is therefore strictly limited in the scope of assets which amount to replacement assets.

⁶ AEMC Rule Determination – Economic Regulation of Transmission Services Rule 2006 No. 18, 16 November 2006, at paragraph 5.3.1.4.

- 20.6 It also excludes asset replacements which occur at the request of the relevant *Transmission Network User* where the replacement asset provides an increased service or a service with a different functionality. The increased (or different functionality) service provided by these replacement assets will be treated as a *negotiated transmission services* under Grid Australia's proposal. It follows that a *Transmission Network User* will not be able to require that these types of asset replacements are funded through the allowances for capital expenditure in the TNSP's *revenue determination*.
- 20.7 Where, under Grid Australia's proposal, an asset replacement is regarded as still giving rise to the provision of a deemed *prescribed transmission service* under clause 11.6.11 it follows that the process of justification and approval for the replacement asset expenditure by the TNSP will have to take place in accordance with the ordinary processes for the TNSP's *revenue determination* under Chapter 6A. The AER will therefore have oversight of the process.
- 20.8 Grid Australia considers that its proposal about replacement assets is a practical means of dealing with the issue of asset replacement. If asset replacements are **not** treated as continuing to give rise to a grandfathered *prescribed connection service* under clause 11.6.11 it follows that it would be necessary to have mechanisms in the Rules which would enable that expenditure to relate to the provision of a *negotiated transmission service*.
- 20.9 It would also follow that on **each** occasion there was an asset replacement (no matter how minor in scope or value) there would need to be agreement reached between the parties as to how the replacement was to be treated, and the costs recovered, between the TNSP and affected *Transmission Network User* as a *negotiated transmission service*.
- 20.10 Grid Australia submits that this approach would place a cost burden on the parties which would exceed any potential benefits which would arise from a negotiation process.
- 20.11 As Grid Australia pointed out in its first submission, the AEMC's comments from its Rule determination of 16 November 2006 as to the appropriate treatment of asset replacements are not reflected in the current provisions contained in the Rules. For example, clause 5.3 and the *negotiating framework* do not provide for the conversion of *prescribed transmission services* to *negotiated transmission services* at the initiation of the TNSP.
- 20.12 If the view is taken that an asset replacement should be regarded as relating to the provision of a *negotiated transmission service* by the TNSP to the *Transmission Network User* there presently is no mechanism by which this can be compelled and the relevant *negotiated transmission service* negotiated between the parties.

20.13 Given these fundamental difficulties which arise from the current structure of the Rules, Grid Australia considers that the preferable course is to recognise that in limited circumstances asset replacements should be permitted to be treated as still giving rise to the continued provision of a grandfathered *prescribed transmission service* under clause 11.6.11.

21. Network reconfigurations

21.1 The NGF has sought to draft changes to the Rules in a way which avoids the possibility of additional assets being attributed to the provision of *connection services* which are deemed to be *prescribed transmission services* under clause 11.6.11 following a *network* reconfiguration which the *Transmission Network User* did not request.

21.2 This situation cannot arise under the Grid Australia proposal because only specified replacement assets can become ‘eligible assets’.

22. Interaction with new Chapter 6A – clause 11.6.11(c)

22.1 Grid Australia’s proposal also follows the approach taken in the NGF’s proposal of seeking to include with clause 11.6.11 provisions dealing with how Chapter 6A applies to those services which are deemed to be *prescribed transmission services* under clause 11.6.11.

22.2 The NGF’s proposal is to include new clauses 11.6.11(d) and (e).

22.3 Grid Australia proposes alternative drafting in its clause 11.6.11(c).

22.4 Proposed clause 11.6.11(c) is drafted to achieve (in a simpler way) the same general purpose which sub-clauses (d) and (e) of the proposed clause drafted by the NGF are designed to achieve. That is, to ensure that:

- (a) all costs attributable to *prescribed transmission services* are allocated amongst the various sub-categories of *prescribed transmission services*; and
- (b) no amount goes unallocated due to the fact that clause 11.6.11 defines prescribed connection services only in terms of eligible assets and limits the assets which may be attributable to the provision of prescribed connection services for the purposes of Chapter 6A to those eligible assets.

22.5 The proposed clause 11.6.11(c) achieves this by directing that any shortfall in costs which, but for clause 11.6.11(c), would have been attributed under the provisions of Chapter 6A to prescribed connection services (i.e. *prescribed entry services* and *prescribed exit services*) will instead be allocated to *prescribed TUOS services*.

- 22.6 Grid Australia understands that the NGF's Rule change proposal is designed to 'grandfather' a **costs** position in relation to the costs which may be allocated to deemed *prescribed transmission services* for the purposes of Chapter 6A so as to preserve the position which previously applied under old Chapter 6 of the Rules.
- 22.7 For example, its proposed clause 11.6.11(d) refers to the 'costs of *transmission system* assets' that may be treated as attributable to or incurred in providing those services.
- 22.8 Grid Australia's view is that this would not amount to an appropriate grandfathering approach. It submits that what is required in clause 11.6.11 is a provision which specifies the extent of the *transmission system* assets which are to be regarded as attributable to or used in the provision of prescribed connection services.
- 22.9 Once that allocation is established by clause 11.6.11, the issue of how that translates on an annual basis into an allocation of costs, and consequently charges for the provision of the service, under Chapter 6A should depend on the ordinary workings of Chapter 6A and the ordinary working of the *pricing methodology* of the *TNSP*.
- 22.10 The consequence of 'locking in', under clause 11.6.11, a specific cost allocation for the purpose of Chapter 6A would result in the relevant *Transmission Network User* being protected from the ordinary changes in the level of charges for the service which result from changes in the *annual service revenue requirement (AARR)* of the *TNSP* under its *revenue determination* from time to time. Grid Australia is not aware of any persuasive argument in favour of such a policy.

23. Clarification concerning Prescribed Transmission Services

- 23.1 It has been suggested to Grid Australia by the NGF that, while it may be argued to be implicit in the Rules, it is not absolutely clear under the Rules that:
- (a) *negotiated transmission services* can only arise through a process of negotiation; and
 - (b) *negotiated transmission services* cannot be deemed to exist between a *Transmission Network Service Provider* and *Transmission Network User* under the Rules in the absence of an agreement between those parties.
- 23.2 As outlined above, the drafting of Grid Australia's alternative proposal is based on the two principles stated above.
- 23.3 Grid Australia considers that it would be desirable for the Rules be clarified to put this beyond doubt.

- 23.4 Grid Australia submits that it would be most appropriate to do so by adding a short new sub-clause to clause 6A.9.2 in Part D of Chapter 6A concerning *negotiated transmission services*. That clause deals with the determination of terms and conditions of access for *negotiated transmission services*.
- 23.5 The proposed amendment is intended be a statement of the only circumstances in which a service is to be taken to be a *negotiated transmission service* for the purposes of the Rules, so as to rule out the possibility of a *negotiated transmission service* arising through deeming rather than actual agreement.

24. Further transitional or consequential provisions

- 24.1 If the AEMC decides to make a proposed Rule (whether that be the NGF's proposal, Grid Australia's alternative proposal, or another Rule) there will be a need for further transitional or consequential provisions to be included in the amending Rule to deal with matters consequential on the transition from the 'old' to a 'new' clause 11.6.11.
- 24.2 The details of the transitional or consequential provisions which will be required have not yet been formulated. The substantive content of these transitional or consequential provisions will depend on the content of the Rule which the AEMC proposes to make. It is therefore premature for Grid Australia to suggest drafting to the AEMC at this time.
- 24.3 The AEMC is authorised to make any further Rule which is necessary or consequential to a Rule which is made on a Rule request⁷.
- 24.4 At this stage, Grid Australia seeks only to highlight the issue of the need for further provisions so that it is brought to the attention of the AEMC and interested parties.
- 24.5 The need for further provisions arises from the fact that the Rule change proposals (both of the NGF and Grid Australia) propose the replacement of clause 11.6.11 by a redrafted clause.
- 24.6 Clause 11.6.11 is itself a transitional or consequential provision which is part of the wider rules in clause 11.6 which were made in consequence of the making of the National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006 – the Amending Rule 2006. The Amending Rule 2006 took effect on the 'commencement date'⁸, namely 16 November 2006.

⁷ Section 91B National Electricity Law.

⁸ Defined in Clause 11.6.1

- 24.7 There are least two possibilities. Either a ‘new’ clause 11.6.11 could operate only from the date it was made, or the ‘new’ clause 11.6.11 could be made to apply in effect retrospectively from the commencement date of the Amending Rule 2006.
- 24.8 Regardless of which approach is taken, the Rule would need to contain provisions dealing with the impact of conduct which has taken place since the commencement date under existing clause 11.6.11 (or under the Rules more generally) in reliance on the position which applies under existing clause 11.6.11.
- 24.9 For example, existing clause 11.6.11 has impacted on the content of *revenue determinations* made by the AER since the commencement date in respect of the allowance made for replacement of assets within the RAB.
- 24.10 The impact on the members of Grid Australia differs between *Transmission Network Service Providers*. Therefore in the same way that existing clause 11.6 contains a number of transitional provisions which apply to specific *Transmission Network Service Providers*, further provisions consequential on the making of a ‘new’ clause 11.6.11 may need to be tailored on a *Transmission Network Service Provider* by *Transmission Network Service Provider* basis.
- 24.11 Grid Australia also wishes to highlight that the issues and complexities involved in identifying the issues and preparing draft consequential provisions may not make this issue amenable to being further progressed before the current date for issue of the AEMC’s draft Rule determination.

25. **Change of status of a service**

- 25.1 Finally, if the AEMC accepts Grid Australia’s proposal that *connection services* grandfathered under clause 11.6.11 as *prescribed transmission services* should ceased to be treated as *prescribed transmission services* when the *connection agreement* under which they are provided expires, there will be situations where a service continues to be provided but ceases to be deemed to be a *prescribed transmission service* under clause 11.6.11 (because it no longer continues to meet all the criteria of being a ‘prescribed connection service’).
- 25.2 This raises a number of practical issues about how the transition is to be handled. In particular, it raises the wider question as to how the principle that grandfathered services may change from *prescribed transmission services* to *negotiated transmission services* is to be reconciled with the *Cost Allocation Principle* in clause 6A.19.2(7) that costs which have been allocated to *prescribed transmission services* must not be reallocated to *negotiated transmission services*.
- 25.3 This question also applies to existing clause 11.6.11.

Annexure 1 to Grid Australia Further Submission

Proposed Alternative Amendments to National Electricity Rules

Part I – Ring-Fencing Arrangements for Transmission Network Service Providers

6A.21 Transmission Ring-Fencing Guidelines

[Amendments to existing Rule are underlined]

6A.21.2 Development of Transmission Ring-Fencing Guidelines

- (a) Transmission ring-fencing guidelines must be developed by the AER in consultation with the *Jurisdictional Regulators* and each *participating jurisdiction* for the accounting and functional separation of the provision of *prescribed transmission services* by *Transmission Network Service Providers* from the provision of other services by *Transmission Network Service Providers* (the '*Transmission Ring-Fencing Guidelines*').
- (b) The *Transmission Ring-Fencing Guidelines* may include, but are not limited to:
 - (1) provisions defining the need for and extent of:
 - (i) legal separation of the entity through which a *Transmission Network Service Provider* provides *network services* from any other entity through which it conducts business;
 - (ii) the establishment and maintenance of consolidated and separate accounts for *prescribed transmission services* and other services provided by the *Transmission Network Service Provider*;
 - (iii) allocation of costs between *prescribed transmission services* and other services provided by the *Transmission Network Service Provider*;
 - (iv) limitations on the flow of information between the *Transmission Network Service Provider* and any other person; and
 - (v) limitations on the flow of information where there is the potential for a competitive disadvantage between those parts of the *Transmission Network Service Provider's* business which provide *prescribed transmission services* and parts of the provider's business which provide any other services; and
 - (2) provisions allowing the AER to add to or waive a *Transmission Network Service Provider's* obligations under the *Transmission Ring-Fencing Guidelines*.

- (c) In developing the *Transmission Ring-Fencing Guidelines*, the AER must consider, without limitation, the following matters:
- (1) the need, so far as practicable, for consistency with Federal and State regulation in each *participating jurisdiction* of ring-fencing requirements of other utility businesses; and
 - (2) the need, so far as practicable, for consistency between the *Transmission Ring-Fencing Guidelines* and *Distribution Ring-Fencing Guidelines*.
- (d) In developing or amending the *Transmission Ring-Fencing Guidelines*, the AER must consult with *participating jurisdictions*, *Registered Participants*, *NEMMCO* and other *interested parties*, and such consultation must be otherwise in accordance with the *transmission consultation procedures*.
- (e) Notwithstanding paragraphs (a), (b), (c) and (d) above and clause 6A.19.2(6), the *Transmission Ring-Fencing Guidelines* must not include any provisions which deal with or require the allocation of costs as between:
- (1) *prescribed transmission services and negotiated transmission services; or*
 - (2) *categories of prescribed transmission services,*
- in a manner which is inconsistent with the *Cost Allocation Principles* or the *Cost Allocation Guidelines*.

Amendments to Chapter 11 [Complete replacement - no mark up]

11.6 Rules consequent on making of the National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006

11.6.11 Transition to new Chapter 6A: existing prescribed connection services

Definitions

(a) In this clause 11.6.11:

- (1) **existing asset** means an asset used in connection with a *transmission system* where the value, or a portion of the value, of that asset was included in the regulatory asset base for that *transmission system* under a revenue determination in force as at 9 February 2006.
- (2) **committed asset** means an asset:
 - (i) that as at 9 February 2006 was committed to be constructed for use in connection with a *transmission system*; and
 - (ii) in respect of which the forecast value, or a portion of the forecast value, of that asset was included in the forecast capital expenditure for that *transmission system* under a revenue determination in force as at 9 February 2006.

For the purpose of this definition, an asset is, and is only, to be taken to be committed to be constructed if it satisfied the criteria which a project needed to satisfy to be a “committed project” for the purpose of the *regulatory test* in force as at 9 February 2006.

- (3) **replacement asset** means:
 - (i) an asset which replaces an existing asset or a committed asset after 9 February 2006; or
 - (ii) an asset which replaces an asset referred to clause 11.6.11(a)(3)(i) after 9 February 2006,

For the purpose of this definition, an asset will be treated as replacing another asset even if it provides an increased or different functionality to the asset it replaces provided that the increased or different functionality was not requested by the relevant *Transmission Network User*.

- (4) **eligible asset** means:
 - (i) an existing asset which was wholly and exclusively used by a *Transmission Network Service Provider* to provide a *connection service* to a *Transmission Network User* or a group of *Transmission Network Users* at a *connection point* immediately before the commencement date;

- (ii) a committed asset which is wholly and exclusively used by a *Transmission Network Service Provider* (when it is first commissioned after 9 February 2006) to provide a *connection service* to a *Transmission Network User* or a group of *Transmission Network Users* at a *connection point*; and
- (iii) a replacement asset which is wholly and exclusively used after the commencement date by a *Transmission Network Service Provider* to continue providing a *connection service* to a *Transmission Network User* or a group of *Transmission Network Users* at a *connection point*,

and excludes an existing asset, a committed asset or a replacement asset to the extent that it ceases to be used after the commencement date to provide a *connection service* to a *Transmission Network User* or a group of *Transmission Network Users* at a *connection point*.

- (5) **prescribed connection services** means a *connection service* provided on or after the commencement date in respect of which, and to the extent that, the following criteria continue to be satisfied:
 - (i) the relevant service is provided using eligible assets;
 - (ii) the relevant service is being provided under a *connection agreement* which was first entered into before the commencement date; and
 - (iii) but for this clause 11.6.11, the service would not otherwise be a *prescribed transmission service* for the purposes of new Chapter 6A.

Prescribed transmission services

- (b) References to *prescribed transmission services* in new Chapter 6A include prescribed connection services under this clause 11.6.11 and, where a service is a *prescribed transmission service* by virtue of the operation of this clause 11.6.11, that service is taken not to be a *negotiated transmission service*.

Interaction with new Chapter 6A

- (c) For the purposes of new Chapter 6A:
 - (1) the *transmission system* assets that from time to time may be treated as:
 - (i) directly attributable to the provision of a prescribed connection service; or
 - (ii) used in providing a prescribed connection service,

are limited to the eligible assets which under this clause 11.6.11 are attributed, from time to time, to the provision of the prescribed connection service;

- (2) any costs:
- (i) in relation to an existing asset, a committed asset or a replacement asset (or any portion of an existing asset, a committed asset or a replacement asset), that is not an eligible asset; and
 - (ii) which but for this clause 11.6.11 would:
 - (A) have been allocated under new Chapter 6A to *prescribed entry services* or *prescribed exit services* as at the commencement date; or
 - (B) be required after the commencement date to be allocated to *negotiated transmission services* under new Chapter 6A,
- must instead be treated as costs that are directly attributable to the provision of, or are incurred in providing, *prescribed TUOS services*; and.
- (3) the *stand-alone amount* for *prescribed TUOS services* is taken to include any portion of the costs referred to in clause 11.6.11(c)(2) that has not been allocated under clause 6A.23.2(d)(1).

Amendment to Part D of Chapter 6A – Negotiated Transmission Services

Clause 6A.9.2 - Determination of terms and conditions of access for negotiated transmission services

Add a new clause 6A.9.2(c):

- (c) For the purposes of the *Rules*, a *negotiated transmission service* is only to be taken to be provided by a *Transmission Network Service Provider* to a *Transmission Network User* if the *terms and conditions of access* of the service have been negotiated between the provider and the person in accordance with the requirements of Chapters 4, 5 and this Chapter 6A of the *Rules*.