Submission to the Australian Energy Market Commission

Re: Review of the Electricity Transmission Revenue and Pricing Rules

UNITED ENERGY Distribution

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TABLE OF CONTENTS

1 Introduction and Summary

The National Electricity Law requires the Australian Energy Market Commission (AEMC) to amend the National Electricity Rules governing the regulation of transmission revenue and prices before 1 July 2006. The AEMC is conducting a review that includes consultation, to develop a Rule change proposal and draft Rules. As part of its review process, the AEMC published a Transmission Pricing Issues Paper in November 2005. The Issues Paper seeks comments regarding the pricing aspects of the AEMC Review.

This submission sets out United Energy Distribution's (UED) response to the Issues Paper.

The AEMC's review is being undertaken in parallel with other important work being overseen by the Ministerial Council on Energy (MCE) – most notably, consultation on a national framework for energy distribution and retail regulation, and the commissioning on 7 December 2005 of an expert panel review of revenue and network pricing across the energy market.

UED understands that the scope of the AEMC's Transmission Pricing Issues Paper is limited to issues relating to the determination and structuring of prices, and that those issues are unique to the electricity transmission sector. UED has responded to the AEMC's Issues Paper accordingly. Readers should not draw inferences from this particular submission as to UED's position on matters beyond the limited scope of the Transmission Pricing Issues Paper.

The AEMC has stated that it has an open mind about the approach to transmission pricing that may be adopted in the revised Rules. At the same time, the Issues Paper acknowledges that the transmission pricing arrangements must complement the consumption, production and investment signals provided by other aspects of the NEM arrangements. These other aspects (namely, the regional pricing structure of the wholesale market, non-firm grid access arrangements for generators, and the transmission investment arrangements including the Regulatory Test) are evidently considered by the AEMC to already provide incentives to generators, consumers and investors to behave efficiently[1]. UED concurs with the AEMC's views in this regard.

In addition, the Issues Paper states that these three key aspects are not within the scope of the AEMC Review. By inference then, these key features are not subject to change, and therefore the new transmission pricing rules must operate effectively within the constraints of the existing market design and the related features described in the Issues Paper.

Within those constraints, UED considers that:

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1 Refer to page 37 of the Issues Paper.

- The economic signals produced under the regional pricing structure provide a reasonable proxy for the short run costs of constraints and losses across the National Electricity Market (NEM).
- Rational behaviour of generator proponents in response to the long run signals provided by the non-firm network access regime would result in a reasonable likelihood that generator investment decisions will be efficient from a locational point of view.
- It seems reasonable to assume that a by-product of the Regulatory Test will be the provision of reasonable locational signals to generators and their alternatives.

These factors, coupled with the consideration that transmission costs comprise on average around 10% of the total cost of delivered electricity somewhat reduce the importance of transmission price signals. UED's experience and observations suggest that whilst the present arrangements are not perfect, they are not fundamentally flawed, nor have they led to materially inefficient consumption or investment decisions in the NEM. On this basis, UED sees no compelling case for radical or wholesale change. Indeed, the company concurs with the following statements made on page 37 of the Issues Paper:

> "It may be necessary to consider whether the theoretical benefits from a change to the pricing Rules may be insufficient to outweigh the transitional and ongoing costs of change. This is an important consideration for the Commission. The Commission is concerned not to change the current pricing arrangements without clear evidence that there will be a demonstrable net gain."

In response to specific matters raised in the Issues Paper, UED's views are summarised as follows:

- Regulation of transmission pricing structures should be light-handed. The Rules should set out high level pricing principles, with which TNSPs must comply in developing their transmission prices. These principles should be focused on the goal of long term economic efficiency, and should be linked explicitly to the NEM objective. Beyond this, UED does not see merit in the Rules prescribing transmission pricing structures.
- TNSPs should be required to design their tariffs in accordance with the principles set out in the Rules. TNSPs should be required to document in reasonable detail the rationale for their tariff structures (in so far as such matters are not prescribed in the Rules) so as to demonstrate how those tariff structures accord with the pricing principles in the Rules.
- The Australian Energy Regulator (AER) should not have any role in determining the nature and form of price regulation. Any such matters should be prescribed in the Rules (through the high-level principles) and the AER's role should be limited to overseeing the Transmission Network Service Providers (TNSPs) compliance with those principles.
- The long-term efficiency objective should not encompass distributional issues *per se*. However, the present review involves the possibility of Rules changes which may lead to a material and unexpected re-distribution of income. The review should therefore carefully consider the implementation plans and transition arrangements associated with any Rules changes that may result in material wealth re-distribution.

- Current Rules governing the allocation of costs between the connection and shared network categories, and payment for connection charges by customers (load) are appropriate and should be continued.
- The Issues Paper states that a regime of transmission property rights will not be implemented. On this basis, there would seem to be little if any rationale for the continued existence of provisions in the Rules relating to negotiation of generator Transmission Use of System (TUoS) charges.
- UED supports the inclusion of provisions in the Rules for TUoS discounting and the payment of TUoS rebates, provided the rebates reasonably reflect avoided incremental costs.
- It may be desirable for the Rules to provide side constraints to limit the movement in transmission prices from year to year (to protect consumers from unexpected price shocks). Beyond this, UED does not see merit in the Rules prescribing transmission pricing structures.
- The Rules should continue to provide for connection charges based on a shallow connection charging approach.
- In the company's experience, regulatory arrangements governing the pricing of excluded or non-prescribed services have worked satisfactorily.
- Policy matters relating to inter-regional transmission pricing should be addressed by jurisdictions prior to Rules changes.

The remainder of this submission sets out UED's detailed responses to the questions set out in the Issues Paper. The structure of the submission reflects that of the Issues Paper.

2 Requirement for Regulation

Question 1	Should transmission prices be regulated and why?
Question 2	If regulation is required what form should this take? For example, should it be less prescriptive and involve greater transparency or be more prescriptive?
Question 3	What role, if any, should the AER have in determining the nature and form of price regulation?

UED considers that there is not a strong case for detailed regulation of transmission prices. UED understands that to date, the ACCC has had limited involvement in detailed regulation of transmission pricing. UED's experience is that the present regime has worked reasonably well. Practical experience therefore provides good guidance as to the form that regulation of transmission prices should take in the future, regardless of the form of price or revenue control to be applied to TNSPs.

UED considers that the Rules should set out high level pricing principles, with which TNSPs must comply in developing the transmission prices. These principles should be focused on the goal of economic efficiency, and should be linked explicitly to the NEM objective. TNSPs should be required by the Rules to design their tariffs in accordance with the principles. Transmission pricing Rules should also require TNSPs to recognise any constraints (such as total network tariff re-balancing constraints) with which distributors must comply in recovering all transmission charges.

Transparency would be enhanced if TNSPs were required to document in reasonable detail the rationale for their tariff structures (in so far as such matters are not prescribed in the Rules) so as to demonstrate how those tariff structures accord with the pricing principles in the Rules.

The AER should not have any role in determining the nature and form of price regulation. Any such matters should be prescribed in the Rules (through the high-level principles) and the AER's role should be limited to overseeing the TNSPs' compliance with those principles.

Finally, the AEMC's Issues Paper raises questions about the efficacy of transmission pricing signals given that such signals may be masked by distributors in bundled network tariffs. In this context, it should be borne in mind that the pricing structures adopted by energy retailers may further mask network-specific price signals. UED therefore agrees that practical constraints governing the presentation of detailed pricing information to end users need to be carefully considered; a pragmatic approach to transmission pricing design and to regulation of transmission pricing should be applied. Having said this, it should also be recognised that the roll-out of interval meters will provide retailers with a means of communicating more accurate price signals to the mass market. As that market continues to develop and mature, it can be expected that the appetite of end-consumers for more sophisticated pricing information will increase.

3 Context and Objectives for the Review

Question 4	Bearing in mind the NEM objective, should economic efficiency of the Rules be the focus or should it also have regard to the distributional consequences of Rule changes?
Question 5	If the NEM objective should have regard to distributional consequences of Rules changes, how should these be taken into account.

UED considers that the long-term efficiency objective does not encompass distributional issues *per se*. Issues and objectives relating to income distribution should be addressed by policy-makers directly through instruments and arrangements such as the progressive income tax system, expenditure transfers and explicit payments by governments to fund Community Service Obligations.

Having said this however, it needs to be recognised that the present review involves the possibility of Rules changes which may lead to a material re-distribution of income. Whilst such re-distributions may be an unavoidable corollary of the pursuit of economic efficiency, the impact of such re-distributions should not be ignored by the review. This consideration highlights the need for the review to carefully consider the implementation plans and transition arrangements associated with any Rules changes that result in material wealth re-distribution. A failure by the review to adequately consider the impacts of Rules changes on market participants' positions (which were committed to under pre-existing Rules) may diminish incentives for future investment in markets upstream and downstream of the transmission sector. This in turn, would have a direct impact on economic efficiency.

4 Current Transmission Pricing Regime

Question 6	Is the allocation of network costs between the connection and shared network categories in the Rules broadly appropriate? If not, how could it be improved?

Current Rules governing the allocation of costs between the connection and shared network categories, and payment for connection charges by customers (load) are appropriate and should be continued.

More detailed comments on the question of allocating shared network augmentation costs to generators are set out in the answer to question 22 below.

Question 7	Should a common service charge be maintained or should these costs be incorporated into another charge? If not, how should common service costs be allocated or incorporated into other charges?

The present approach to recovering the costs of common services should be maintained. UED understands that common service costs are those that cannot reasonably be allocated on a locational basis. The present arrangements for recovering such costs are intended to minimise distortions to cost reflective network pricing signals. It is UED's view that these arrangements are reasonably effective in achieving this outcome.

Question 8	Should generator and MNSP use of system charges remain a matter for negotiation with the TNSP or should they be prescribed in the Rules?

At present, all shared transmission network costs are borne by load customers. In the NEM, generators only pay for the costs of assets that connect their facilities to the shared network; therefore, generators do not currently pay a network usage charge. It is reasonable to posit that the level of shared network service provided to the generators is commensurate with the TUoS charges paid by them, since the shared network provides generators with only "non-firm access" to the regional reference node.

UED understands that the present Rules providing for negotiation of TUoS charges between a generator and a TNSP were put in place to enable generators to seek and pay for "firm access". Under such arrangements, a generator that had purchased firm access from a TNSP would be entitled to compensation from the TNSP in the event that the generator was constrained by the shared network from delivering a specified and agreed amount of capacity to the wholesale market. This arrangement was intended to supplement the locational signals (namely, loss factors and inter-regional pool price differences) already seen by prospective new generators in the NEM:

- TNSPs would manage the risk associated with selling "firm access" by building sufficient network capacity to facilitate reliable delivery of the contracted amount of generation to the market.
- The price of firm access would reflect the incremental cost of providing the required level of network capability. Hence, the price of firm access would be lowest at those nodes where spare capacity existed.

An assumption underpinning this regime appears to be that TNSPs would be willing and able to sell "firm access". This has not, to date, occurred. The Issues Paper notes that generators believe there is little point in paying for network augmentation without property rights to the capacity created. In addition, page 37 of the Issues Paper states:

> "The creation of property rights over the shared network will not be considered [by the present AEMC review]… Greater specification of generators' access network rights – as requested in The Group, [TRUenergy, International Power, Loy Yang Marketing Management Co, NRG Flinders] AGL and VENCorp submissions – will not be addressed in this Review. The issue of compensation payments from one network user to another will also not be considered as these obligations may create de facto shared transmission property rights."

Given these statements, there would seem to be little if any rationale for the continued existence of provisions in the Rules relating to negotiation of generator TUoS charges. It is noted that the relevant provisions are set out in clause 5.5(f) of Chapter 5 of the Rules.

Question 9	If a modified CRNP usage charge is to remain option: • Should the Rules prescribe the criteria for the AER to accept implementation of modified CRNP? and • Should any network customer (rather than just the TNSP) be able to request that the modified CRNP methodology be implemented?

UED believes that the Rules should prescribe the criteria for the AER to approve the implementation of modified Cost-Reflective Network Pricing (CRNP). Such arrangements would provide for consistent application of the acceptance criteria, while the Rules and criteria governing the assessment and approval of applications to apply modified CRNP would be made clear to all stakeholders.

TNSPs should not be required to consider applications made directly by customers for the modified CRNP approach to be applied. However, a customer should be permitted to make a case to the AER to initiate application of the modified CRNP approach. Any such application would be assessed by the AER according to the criteria set out in the Rules.

Question 10	How well do the CRNP and modified CRNP methodologies accord with efficient pricing principles? Could simpler approaches be applied to produce similar outcomes?
Question 11	If the CRNP and/or modified CRNP methodologies were to be retained are the descriptions of the methodologies in the Rules sufficiently detailed and clear? If not, how could they be clarified?

Independent economic regulators have adopted principles to guide network tariff setting that are broadly consistent with following[2]:

- *Tariffs for individual customers should lie between the incremental cost (lower bound) and stand-alone cost (upper bound) of serving them*. This principle ensures that customers pay at least the cost that their additional usage places on the system and not more than the cost to provide the service on a stand-alone basis. Requiring tariffs to be above incremental cost ensures that network service providers have an incentive to continue providing the service and that customers receive an appropriate signal as to the value of resources consumed in meeting their demand. Requiring tariffs to be below stand-alone cost precludes inefficient bypass of the network.

- *The allocation of fixed or common costs should be transparent*. This principle recognises that apart from the first principle set out above, economic criteria provide no material guidance on how fixed and common costs should be allocated between different customers. There is a wide range of allocations that could potentially be regarded as economically 'efficient'. Therefore, considerations of best practice suggest that whatever allocation is made, it is transparent, as this enhances predictability and accountability.

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2 *Public Consultation on a National Framework for Energy Distribution and Retail Regulation*, Paper prepared for the Ministerial Council on Energy (Australia) by NERA Economic Consulting and Gilbert + Tobin, May 2005, pages 27-29.

- *Network service providers should be permitted to give prudent discounts on published tariffs*. "Prudent discounts" reduce costs for all customers, compared to a situation in which discounts were not allowed and marginal customers subsequently bypass the network. Network service providers should be allowed to recover the revenue foregone as a result of such discounts from other customers.

UED understands that these principles broadly underpin the present approach to transmission pricing set out in the Rules. As noted in the response to question 2, transparency would be enhanced if TNSPs were required to document in reasonable detail the rationale for their tariff structures (in so far as such matters are not prescribed in the Rules) so as to demonstrate how those tariff structures accord with the pricing principles in the Rules.

Question 12	It is appropriate to provide scope for TUoS discounting in the Rules?
Question 13	If so, could the existing arrangements be refined and how?

As noted in the answer to questions 10 and 11 above, UED supports the inclusion of provisions in the Rules for TUoS discounting.

UED has no firm views on the question of whether the existing arrangements should or could be refined.

Question 14	It is appropriate to prescribe arrangements for TUoS rebates in the Rules? If so, could the existing arrangements be refined and how?
Question 15	Do the current pricing arrangements appropriately cover alternatives which contribute to the avoidance or postponement of transmission augmentation?
Question 16	Should TUoS rebates also apply to generators connected to the transmission network, DSM or other non-electricity options? Does this depend on whether generators generally pay shared transmission costs?

UED supports the concept of TUoS rebates, as they provide a means of encouraging new generation to locate in areas where the avoided costs of transmission augmentation are highest. The TUoS rebate should provide a reward to new generation that reflects the avoided incremental cost of transmission network expansion at the relevant location.

In principle, TUoS rebates should be available to generators connected to the transmission network, as well as Demand Side Management (DSM) or other non-electricity options. In practice however, TUoS rebates and any contracting arrangements (for generators providing network support, for instance) would have to be carefully designed to avoid over-signalling the value of new generation, demand side measures and any other non-electricity options.

At the transmission level, it is probably feasible to calculate the change in long run marginal costs attributable to a particular generation, DSM on non-electricity option, and to determine the maximum reward (rebate) with reference to those calculations. UED understands that this approach was applied by the Essential Services Commission (ESC) in Victoria in relation to the determination of avoided network cost payments to the owners of Somerton Power Station.[3]

5 Efficiency and Transmission Pricing – Key Concepts

Question 17	Should transmission pricing arrangements principally seek to promote efficiency in the short or long run?
Question 18	If transmission pricing arrangements should consider both the short and long run, what approach should the Commission take to determine the appropriate balance between these aims?

The NEL objective refers to the long-term benefit of consumers so UED considers that the pricing arrangements should focus on fostering long run efficiency.

In addition, as noted in section 6.1 of the Issues Paper, the present design of the wholesale electricity market and the design of the transmission pricing, planning, augmentation and regulatory arrangements are complementary and very closely inter-related. The present arrangements contain features (such as the regional pricing structure and non-firm grid access for generators) that provide short-run economic signals. Under the present market design, the role of the transmission system is one of an open-access common carrier. In this overall context, it seems appropriate that the transmission pricing design provides signals that reflect long-run costs.

6 Relevant NEM Context

Question 19	To what extent are existing signals from other aspects of the NEM arrangements (or requirements from regulatory settings outside the NEM) sufficient to promote efficient behaviour by actual and potential consumers and producers of electricity in the short and long run?

UED generally concurs with the analysis set out in section 6.1 of the Issues Paper. In particular, UED considers that:

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3 In that case, avoided cost payments were based on the difference between the least cost series of augmentations that would be required to meet demand growth, at an equivalent level of security and reliability, if: Somerton Power Station does not proceed; and network support services are provided by Somerton Power Station in accordance with the proponent's proposal.

- Economic signals produced under the regional pricing structure provide a reasonable proxy for the short run costs of constraints and losses across the NEM.
- The generator proponent responses to the non-firm access regime described in the Issues Paper appear to be rational. The rational behaviour of generator proponents in response to the long run signals provided by the non-firm access regime results in a reasonable likelihood that generator investment decisions will be efficient from a locational point of view.
- Subject to the discussion below, it seems reasonable to assume that a by-product of the Regulatory Test is that it provides reasonable locational signals to generators and their alternatives. This feature, combined with non-firm access and the signals provided by regional wholesale prices, reduces the importance of transmission price signals.

On the matter of the signals provided by the Regulatory Test, UED generally concurs with the analysis set out in Appendix 1 of the Issues Paper. That analysis relies on an assumption that the proponent of a new generator (that would trigger the need for shared network augmentation) would take the cost of that augmentation into account in assessing the viability of the new generator, even though the proponent is not required to fund shared network augmentation costs. UED considers that this assumption is not unreasonable, as the generation project is exposed to the risk of “stranding” unless the required shared network augmentation proceeds. The augmentation will only proceed if it satisfies the Regulatory Test.

It is possible, in theory at least, that a generation proponent may commit to new generation investment, so that by the time the Regulatory Test is performed, that committed (unavoidable) generation investment is treated as a sunk cost and is excluded from the Regulatory Test analysis. Such an outcome, if it were to arise, may lead to inefficient network development. In practice however, it is more likely that the proponents of a new generation development (and their financiers) would require a high degree of surety that any necessary shared network investments will proceed before committing funds to the generation project. In practice then, it would be reasonable to expect generation proponents to seek to demonstrate through the Regulatory Test that their proposed project combined with any associated network augmentations maximises net market benefits.

In view of the foregoing discussion, UED considers that there would be merit in considering modifications to the Regulatory Test, ANTS and Annual Planning Review processes to provide a more formal framework within which proponents of new generation projects would apply the Regulatory Test to demonstrate the economic feasibility of shared network augmentations associated with their proposals.

Question 20	Given current distribution network pricing arrangements, it is appropriate to prescribe transmission pricing structures in the Rules?
Question 21	If so, should prescription be limited to prices for particular network users?

As noted in its answers to questions 2 and 11, UED considers that the Rules should prescribe high level pricing principles that are consistent with the NEM objective, and which therefore emphasise the goal of long-term efficiency. In addition, it may be desirable for the Rules to provide side constraints to limit the movement in transmission prices from year to year (thus protecting consumers from unexpected price shock). Beyond this, UED does not see merit in the Rules prescribing transmission pricing structures.

UED also considers that the pricing principles should apply to all classes of end consumers, as there is no economic reason for restricting the application of those principles to specific classes.

7 Allocation of Regulated Revenue Across Transmission Users

Question 22	Should NEM connection charges continue to be based on a shallow connection approach or should a deep connection approach be adopted?
Question 23	Of a shallow connection approach is broadly to be maintained, are there any circumstances where connecting parties should pay for up or downstream upgrades to the shared network?
Question 24	If a deep connection approach is to be adopted in the NEM, how should it be formulated?
Question 25	Is a deep connection approach compatible with the open access transmission regime of the NEM (which is not a subject of the present Review)? If so, how should potential "free-rider" effects be managed?

UED agrees that the Rules should continue to provide for connection charges based on a shallow connection charging approach. Connection costs should be recovered directly from the connecting party when making the actual connection. UED believes that the complications (outlined below) associated with the deep connection approach, coupled with the costs associated with changing the present approach would outweigh any benefits that may accrue as a result of the change.

In this regard, it is noteworthy that following public consultation in Victoria, the ESC has adopted a principle that embedded generators must pay 'shallow connection' costs only, and defined 'shallow connection' as connection assets and any augmentation of the distribution system up to and including the first transformation in the distribution system. The costs of deep augmentation are recovered through network tariffs.

The ESC's Final Decision on its Embedded Generation Guideline stated:

> "If embedded generators were required to pay deep connection costs, they would be disadvantaged compared with transmission connected generators that are not required to pay this amount."

UED understands that the international trend has also been towards a shallow approach to connection charging.

For instance, in its statement on charges for connection to the Electricity Supply Board's transmission system, the Commission for Electricity Regulation in Ireland stated:

> "The Commission believes that adopting the principle of deep connection charges would be:
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> - difficult and arbitrary to apply in practice;
> - discriminatory, notably between existing generators and new entrants. While a "deep" connection charging policy could be consistently applied to all new connections, it would be impossible to execute consistently for all existing connections, given the historic nature of the transmission system. Thus it would be impossible now to determine for each existing connection to the system what remote reinforcement costs were necessary in the past to accommodate those connections, and hence what an appropriate connection charge should be in each case. A "deep" connection charging policy would therefore almost certainly discriminate between existing and new users of the system;
> - not cost-reflective, in the sense that remote reinforcement can be argued to be of benefit to a great number of users of the transmission system, since it results in a more secure and reliable system than would otherwise have been the case. Under a "deep" connection charging policy, a new user would be subsidising another user's requirements."

Similarly, in the UK, OFGEM adopted a shallow connection charging policy in 2003. The movement to a shallow connection policy resulted from users raising concerns regarding the previous (deep) connection charging methodology, which they felt was restricting competition and creating barriers to new entrants. Many of these issues were caused by the unpredictability and volatility of deep connection charges, driven by factors outside the user's control. These issues included that:

- deep connection charges depend on the reconfiguration of the network required to connect the new user, which is a function of the attributes of all connected users and not only of the new user; and
- system augmentation is driven by a number of factors, including licence obligations, and not only by new connections. Costs arising from investment decisions driven by wider system developments are more appropriately borne by all users in proportion to the benefit that they derive from the network.

If the shallow connection approach is maintained, it is unlikely that there would be circumstances in which connecting parties would be required to pay for upstream or downstream upgrades to the shared network. The cost of reinforcing the network beyond the connection assets should be recovered through use of system charges. This ensures entry into the market is encouraged and simplifies the associated network charging arrangements. In addition, these arrangements allow a connecting party to readily identify the assets involved in providing connection services, and to assess costs associated with their particular connection decisions.

Finally, shallow connection charging arrangements also ensure that subsequent connecting parties do not get a “free ride”. Whilst a reimbursement scheme could be implemented to manage free rider effects, such schemes are costly and complicated to administer, and may still lead to inequitable outcomes.

Question 26	Do signals from the regional pricing structure of the NEM, non-firm generator access and the transmission investment arrangements provide efficient locational and operational signals to generators, loads and competing sources of energy supply?
Question 27	Are there reasons why generators should make some contribution to shared network costs? If so, what approach should be used to determine the share of shared network costs should be paid by generators?

As noted in the answer to question 19 above, UED generally considers that the regional pricing structure of the NEM, non-firm generator access, and the transmission investment arrangements provide efficient locational and operational signals to generators, loads and competing sources of energy supply.

UED understands that generators can make a contribution to incremental shared network costs through the provisions governing "funded augmentations" set out in clause 5.6.6B of the Rules. Beyond that, for the reasons set out in response to questions 22 to 25 above, UED sees little merit in changing the Rules to require generators to make some contribution to shared network costs. Certainly, UED sees no merit in changing the Rules in order to allocate a share of sunk network costs to generators.

Question 28	Is the current shared network charging regime the best approach for achieving the NEM objective? If not, what improvements could be made?
Question 29	Are there arrangements operating in other jurisdictions for the recovery of shared network costs that would be more appropriate for the NEM? If so, which jurisdictions and which aspects of their arrangements would be appropriate for the NEM?

In UED's experience and observations suggest that whilst they are not perfect, the current shared network charging regime is not fundamentally flawed, nor has it led to materially inefficient consumption or investment decisions. On this basis, UED sees no compelling case for radical or wholesale change. Indeed, the company concurs with the following statements made on page 37 of the Issues Paper:

> "It may be necessary to consider whether the theoretical benefits from a change to the pricing Rules may be insufficient to outweigh the transitional and ongoing costs of change. This is an important consideration for the Commission. The Commission is concerned not to change the current pricing arrangements without clear evidence that there will be a demonstrable net gain."

Question 30.	How much discretion should TNSPs have to discount charges?
Question 31.	Should TNSPs be entitled to recover the cost of discounts from other loads?
Question 32.	Should any conditions for recovering the cost of discounts from other customers be prescribed in the Rules or left to the AER to determine? If so, what should be the general content of these Rules or AER discretions?

UED supports the continuation of provisions enabling TNSPs to offer prudent discounts.

Under the provisions set out in the AER's Statement of Regulatory Principles governing the roll-forward of TNSPs' regulatory asset values, TNSPs would not be exposed to the risk of stranded assets as a result of inefficient bypass. Since the costs of such bypass decisions will ultimately be borne by the remaining network users, it is important to have arrangements in place that enable some contribution to the costs of the network to be recovered from economically marginal transmission users. Prudent discounting arrangements provide an effective mechanism to mitigate the risk of inefficient bypass, and to reduce the costs that would otherwise be borne by all other users of the network.

Principles governing the prudent discounting arrangements should be set out in the Rules. The Western Australian Electricity Network Access Code and the Access Arrangement proposal submitted recently by Western Power pursuant to that Code provide a prudent discounting framework that merits the AEMC's consideration.

There may be merit in introducing provisions that enable regulatory approval of discounts to be obtained on a case-by-case basis. This would provide additional surety to customers that the costs of prudent discounts borne by other customers are minimised, and that TNSPs' discounted offers are consistent with the principles set out in the Rules.

Question 33	Should avoided TUoS rebates be retained in the Rules or left for negotiation between the DNSP and connected party?
Question 34	Is the appropriateness of TUoS rebates contingent on whether generators pay shared use of system charges?
Question 35	If TUoS rebates are retained, what charges should they comprise?

As already noted in answer to questions 14 to 16, TUoS rebates should ideally reflect transmission costs avoided as a result of the rebate recipient's actions.

8 Structure of Prices

Question 36.	To what extent is it necessary or worthwhile to prescribe transmission pricing structures in the Rules in order to promote the NEM objective?
Question 37.	Would it be appropriate to provide guidance to TNSPs on what pricing should achieve instead of prescribing the structure? If prescription is required, which charges should have price structures prescribed in most detail?
Question 38.	Should the degree of pricing structure prescription vary depending on the relevant class of network user paying the charge? If so, how could this be implemented?
Question 39.	How much discretion over charging structures should be left to the TNSP and the AER?

Rules should be sufficiently broad to enable TNSPs to determine the structure of their prices, subject to the pricing principles set out in the Rules. Those principles can and should provide the guidance to TNSPs on the outcomes that pricing should achieve. It is unnecessary and probably undesirable to prescribe pricing structures, since TNSPs in different parts of the country are likely to face particular circumstances and characteristics (eg network configuration and location of load, generation and spare capacity) which are unique, and which warrant the application of particular pricing structures to facilitate efficient outcomes.

There is not, in UED's view, any basis for presuming that the degree of pricing structure prescription should vary across customer classes.

As noted in the answer to question 2, the AER should oversee the compliance of TNSPs' prices with the principles contained in the Rules. The AER itself should have no discretion in the matter of pricing structures.

9 Pricing of Non-prescribed Services

Question 40.	Are the negotiation provisions in the Rules regarding prices for non-prescribed services appropriate? What difficulties (if any) have been experienced?
Question 41.	Should Rules provide criteria in relation to pricing outcomes for non-prescribed services?
Question 42.	Should a price monitoring regime be considered for non-prescribed services?
Question 43.	If so, what criteria would be appropriate? Would these be the same for all non-prescribed services?
Question 44.	Are the current dispute resolution provisions in Chapter 8 of the Rules appropriate for disputes over pricing of non-prescribed services? What (if any) alternative dispute resolution processes may be appropriate?

UED itself has not experienced any problems under the present arrangements. These arrangements encompass the provisions set out in the National Electricity Rules as well as those set out in regulatory instruments (principally, the transmission licences) administered by the Victorian ESC.

In this regard, it is noteworthy that in December 2000, the ESC's predecessor (the Office of the Regulator-General) issued a *Guidance on Fair and Reasonable Terms for the Provision of Unanticipated Transmission Connection Services.*[4] The purpose of that document is to provide guidance to Victorian electricity network licencees - both distribution and transmission - as to the Office's views on fair and reasonable offers for transmission connection assets (termed "non-prescribed services" in the Issues Paper). In effect the

[4] See: http://www.esc.vic.gov.au/PDF/2000/guidancefairterms.pdf

guidance provides a means of regulating terms and charges for excluded services[5] where contestability in provision of the services is not feasible. The matters set out in the Guidance are worthy of the AEMC's consideration.

Where such services can be procured on a contestable basis, then terms and conditions for provision of the services can and should be set in the market place. In such circumstances, there appears to be no need for regulatory involvement.

10 Inter-regional Issues

Question 45	Could the current provisions in the Rules regarding inter-regional TUoS payments be improved? If so, how?
Question 46	What are the impediments, if any, to reaching interregional agreements?
Question 47	Should the Rules provide criteria for determining the "extent of use of a network'? If so, what criteria would be appropriate?
Question 48	Is there a need for greater clarity in the Rules on the treatment of the negotiated charge paid by the importing region to the exporting region for the purpose of determining annual aggregate revenue requirement of a TNSP?
Question 49	Would it be appropriate to extend the expiry date of clause 8.6.5(a)(5)(ii) from 1 July 2006 to 31 December 2006 to coincide with the conclusion of the Commission's review?
Question 50	Do the current, or alternative arrangements provide TNSPs with adequate incentives to invest in assets that facilitate electricity flows between adjacent jurisdictions? If not what improvements could be made?
Question 51	Should the negotiations of inter-regional payments be between TNSPs rather than jurisdictional governments?
Question 52	Should incentives/penalties be in place in the Rules to ensure that an inter-regional agreements is in place?
Question 53	Should the provisions of clause 3.6.5 be replaced by a modified approach to TUoS pricing more generally?

The present regulatory framework consists of:

- revenue capping arrangements that ensure that TNSPs in receipt of inter-regional settlement residues cannot benefit commercially by constraining inter-regional flows;
- incentive mechanisms (albeit arguably relatively weak ones) to encourage TNSPs to optimise the performance and availability of their networks; and

5 The costs and revenues of such services are excluded from the TNSPs' revenue cap, but they are still subject to regulation, given the monopoly characteristics of the services.

- a new investment regime that includes the Regulatory Test, and provisions relating to publication of Annual Planning Reviews and the Annual National Transmission Statement.

This framework seems to provide TNSPs with adequate incentives to invest in assets that facilitate electricity flows between adjacent jurisdictions.

UED understands that the question of inter-regional (ie inter-state) TUoS settlements is one that continues to be of interest to jurisdictional governments because of the scope for such settlements to give rise to potentially large wealth transfers between states. It is possible that this consideration has been one of the factors that has led to the absence of a transmission pricing methodology that accommodates inter-regional TUoS charges. In addressing this issue, there is likely to be some friction between objectives relating to economic efficiency and those relating to wealth distribution. Resolution of such matters is the domain of jurisdictional policy makers.

Until such matters are clearly resolved by policy makers, it would seem premature to seek to impose sanctions or incentives on TNSPs through the Rules to ensure that inter-regional agreements are in place.