NATIONAL GENERATORS FORUM

Cost Allocation Arrangements for Transmission Services

NGF Rule Change Proposal

AEMC briefing

13 March 2008

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Outline

1. Introduction – John Boshier
2. Proposals – Simon Appleby
3. Benefits – Erin Bledsoe
4. Examples – John Arneaud

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1. Introduction

Process:

- Issues identified
- Common concerns emerged for NGF
- Engaged legal input and economic consultants
- Submitted proposal and follow up material
- Contacts:
  - John Boshier
  - Subject matter experts: Simon Appleby, Erin Bledsoe, John Arneaud/David Bowker

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1. Introduction

The Problem: **Connection Cost Uncertainty**

- Significant cost shifting possible
- Exposure to unpredictable step increases in charges
- Connection cost volatility increases investor risk
- Dramatic increase in generator connections expected

The Objective: **Connection Cost Stability**

- Address some anomalies that have arisen under new transmission revenue and pricing framework
- Promote connection cost stability for all entry and exit services
- Maintain transmission revenue certainty
- Preserve intent of transmission connection framework

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2. Proposals

Background:

- Transmission revenue and pricing review 2006
- New cost allocation and pricing framework (Ch 6A)
- Negotiation framework for new connections (6A.9)
- Grandfathering arrangements for prescribed entry / exit (11.6.11)
- Attribution based cost allocation (6A.19.2)
- Priority ordering approach for prescribed service costs (6A.23.2):
    1. TUOS
    2. Common services
    3. Entry / exit services

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2. Proposals

Issues:

- Some practical anomalies apparent:
  1. Reconfigurations potentially move asset boundaries and shift shared costs to prescribed entry
     - But not to negotiated entry (6A.19.2((7))
     - Ageing network may result in increasing reconfigurations – an industry wide issue
     - Connected parties exposed to step change in costs
  2. Shared network costs can migrate to prescribed entry services over time
  3. Reconfigured assets can be optimised out of the RAB and negotiated charges imposed

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2. Proposals

Consequences:

- Impact on market operation and efficiency (eg dynamic)
- Inconsistency with shallow connection charging policy for existing generators
- Undermines priority ordering approach
- Connection charging uncertainty and instability for participants
- Potential price shocks in moving to new framework
- Inequity between negotiated and prescribed entry charges
- Increased scope for charging disputes

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2. Proposals

1. Reconfigurations can move asset boundaries and shift shared costs to prescribed entry
   - Clarify intended operation of 11.6.11
2. Shared network costs can migrate to prescribed entry services over time
   - Roll forward pre-existing cost allocation under 11.6.11
3. Reconfigured assets can be optimised out of the RAB and negotiated charges imposed
   - Clarify optimisation process for reconfigured assets under S6A.2.3(a)
4. Other – Ring Fencing tidy up changes

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2. Proposals

1. Operation of 11.6.11:
   - Appears to grandfather services provided by prescribed entry asset (existing 9 Feb 06) as at 16 Nov 06
   - Any additional connection services provided by a reconfigured network asset are not grandfathered
     - "…but for this clause" (11.6.11(a))
   - As a connection service, these additional services must therefore be classified as negotiated
   - Previously shared prescribed network costs must not be reallocated to negotiated (6A.19.2(7))
   - Rule change confirms this interpretation (11.6.11(aa)-(c))

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2. Proposals

2. Preserve pre-existing cost allocation
   - New ‘directly attributable’ approach places no upper limit on level of entry costs
     - Very extensive connection charging possible
     - Despite priority ordering approach
   - Previous allocation method capped entry costs at “fully dedicated” asset costs
- Rule change rolls forward existing cost allocation as upper bound (11.6.11(d))
- Rule change preserves revenue recovery (11.6.11(e))

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2. Proposals

3. Optimisation of reconfigured assets
   - Assets can leave the RAB only if (S6A.2.3(a)):
     - Dedicated to one user (or group of users); and
     - RAB value exceeds $10m; and
     - Asset no longer providing prescribed services; and
     - TNSP has not adequately managed risk; and
     - AER determines criteria met (discretionary)
   - Fairly limited range of circumstances…but potentially exposes connected parties to reconfigured asset costs nonetheless

- Rule change adds clarity for reconfigurations ((S6A.2.3(a)) - no optimisation if:
  - User has not requested or consented to reconfiguration; or
  - User has not unreasonably refused or failed to consent to optimisation (failure to agree deemed not unreasonable if charge increase exceeds 5%)

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2. Proposals

4. Other issues - Ring Fencing clarifications
   - Intent of ring fencing is to separate transmission from non-transmission revenue
   - Current wording found to allow Ring-Fencing Guidelines to deal with cost allocation between categories of transmission services (eg 6A.21.2(b)(1)(iii))
   - Potentially conflicts with Cost Allocation Principles

- Rule change amends 6A.19.2 and 6A.21.2 to clarify

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2. Proposals

- Out of scope:
  - Network access (physical or financial) –> no change
  - Compensation for loss of connection –> not in scope
  - Regulatory Test –> no change
  - Causation based allocation –> not in scope
  - Generator driven connection –> no change
  - Cost sharing on attribution basis –> no change
- Proposals preserve intent of new transmission cost allocation and pricing framework
- Minor clarification of apparent anomalies only

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3. Benefits

- Prevents inefficient cost shifting
- Reduces inefficiency of new price signals on sunk investments
- Reduces regulatory uncertainty
- Improves consistency of treatment of generators
- Increases stability and predictability of framework
- Achieves price stability
- Removes inconsistency with shallow connection charging policy
- Delivers proportionate and robust change

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3. Benefits

Efficiency impacts:

- Dynamic – investor certainty & reduced entry barriers
- Allocative – downward pressure on delivered energy cost
- Productive – removes unwarranted risk and cost

- Improves connection charge certainty for connected parties:
  - Prevents price shocks and wealth transfer from connected parties
  - Significant risk and cost impact avoided
- Trivial impacts on network users generally:
  - No wealth transfer - shared network costs maintained at existing level
  - Immaterial cost impact when smeared over TUOS base
- Net impact:
  - lowered delivered cost of energy
  - Meets short and long term consumer interests

✓ Satisfies the National Electricity Objective

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3. Benefits

- Specific examples to follow
- Not isolated examples – symptoms of general problem
- Quantification difficult – risk applies across all connected parties
- More appropriate to consider impact in qualitative sense

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3. Benefits

- In summary, the package delivers:
  - Greater connection charging certainty and stability for connected parties (generators/customers alike)
  - Continued revenue certainty for TNSPs
  - Less scope for disputation
  - Improved efficiency (esp dynamic) and promotion of the National Electricity Objective

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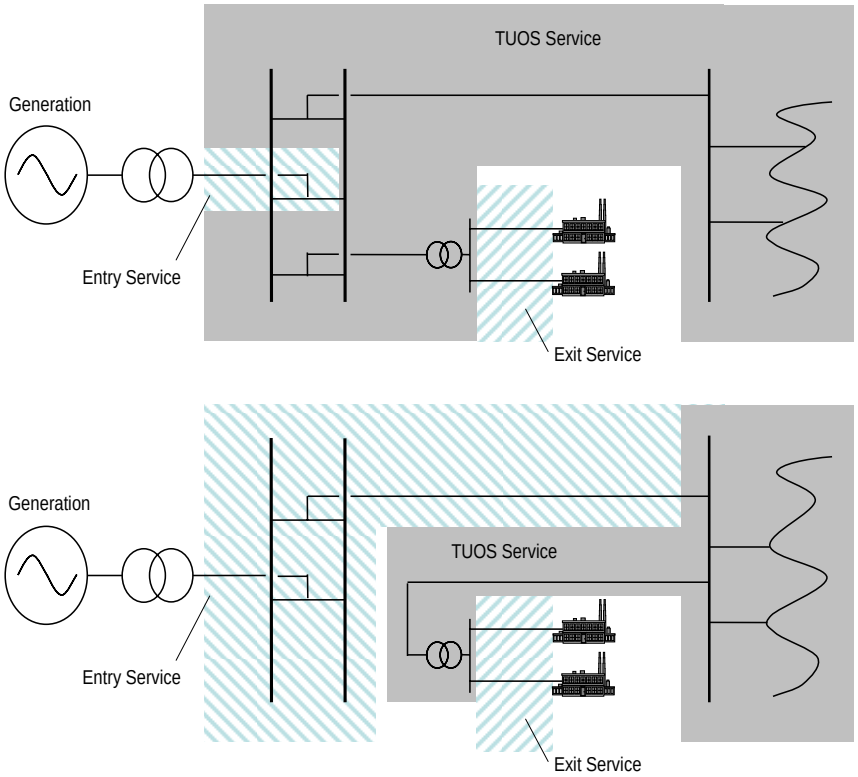
4. Examples

Scenario 1: Reconfiguration impacting on entry service



Before - limited assets are attributed solely to entry

After - large set of assets are attributed to entry

Solution - quarantine additional entry costs to prescribed network charges (11.6.11)

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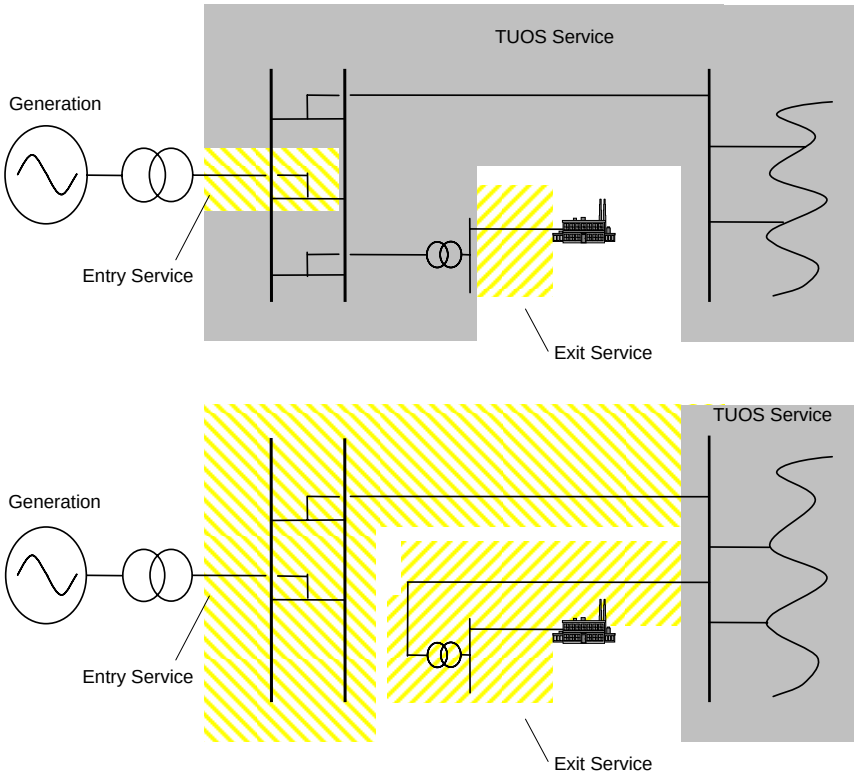
4. Examples

Scenario 1a: Reconfiguration impacting on entry service



Before - limited assets are attributed solely to entry

After - large set of assets are attributed to entry

Solution - quarantine additional entry costs to prescribed network charges (11.6.11)

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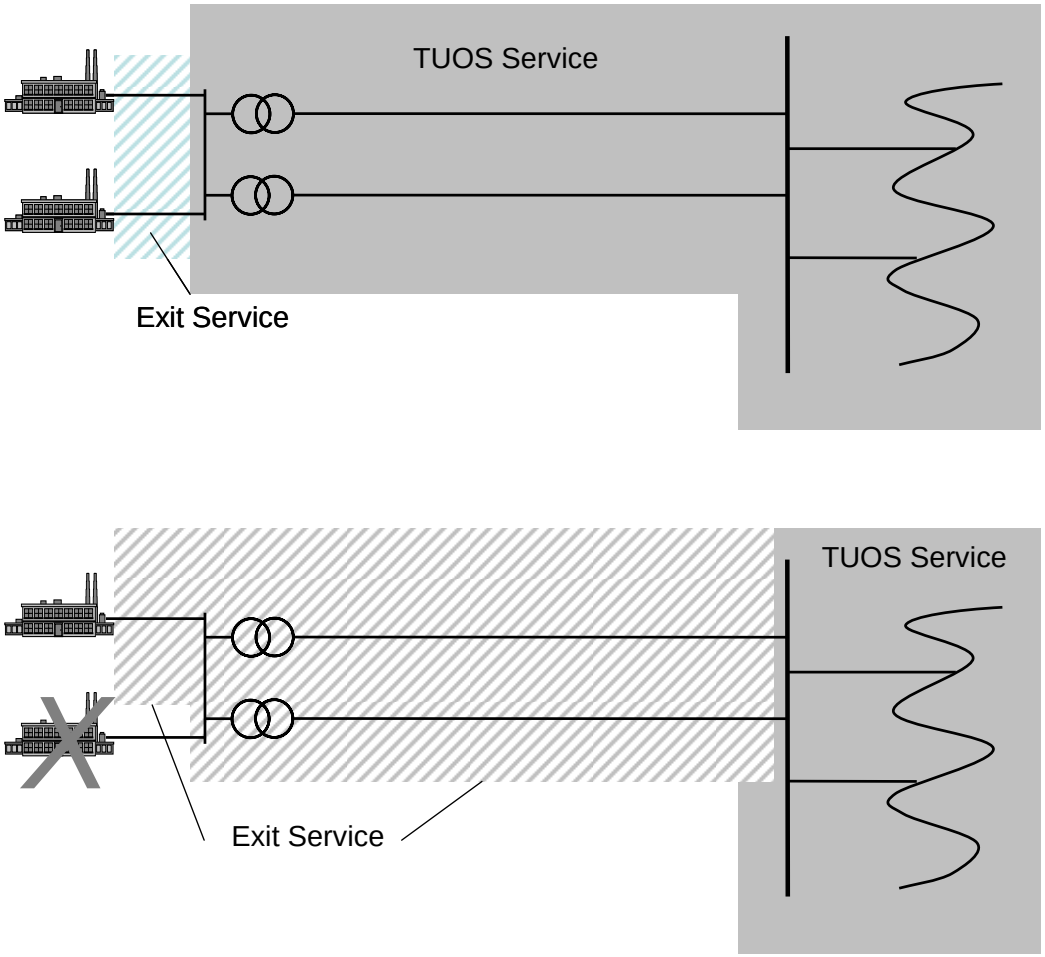
4. Examples

Scenario 2: Reconfiguration impacting on exit service



Before - limited assets are attributed solely to exit

After - large set of assets are attributed to exit

Solution - quarantine additional entry costs to prescribed network charges (11.6.11)

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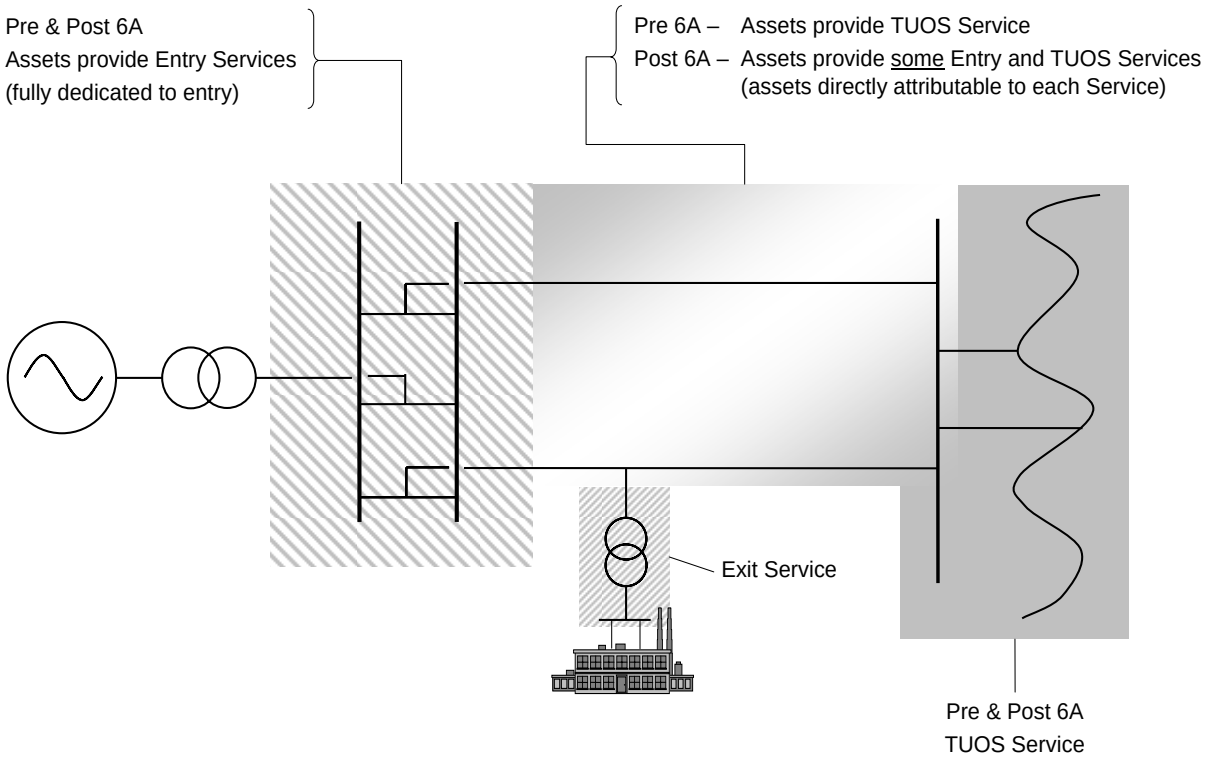
4. Examples

Scenario 3: Asset reclassification under new framework



Pre 6A - limited assets are fully dedicated to entry / exit

Post 6A - larger set of assets potentially 'attributable' to entry / exit

Solution – roll forward cost allocation under (11.6.11)

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- Questions?

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