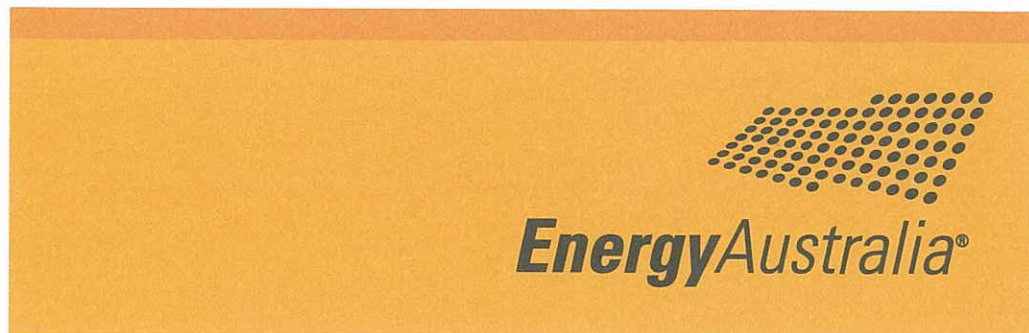


Trevor Armstrong
Executive General Manager
System Planning & Regulation

Level 9, 570 George Street
Sydney NSW 2000

Address all mail to:
GPO Box 4009
Sydney NSW 2001

Telephone +61 2 9269 2611
Facsimile +61 2 9269 7294



6 July 2010

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

AEMC Reference ERC 0106

Dear Dr Tamblyn

Response to Rule Change Consultation Paper - National Electricity Amendment (Inter-regional Transmission Charging) Rule 2010

EnergyAustralia is pleased to respond to the Australian Energy Market Commission (AEMC) on its Consultation Paper on amending the National Electricity Rules (Rules) to establish Inter-regional Transmission Charging. Please accept this late submission.

EnergyAustralia accepts that this proposed Rule change is most likely to have an impact on the co-ordinating NSP in each jurisdiction, which in NSW is TransGrid. However, the flow-on effects to other TNSPs, DNSPs and ultimately customers also needs to be adequately analysed and considered.

There are three principal matters associated with this proposed Rule change on which EnergyAustralia wishes to comment, as follows:

- The pricing effects on customers, which appear not yet to have been analysed by the AEMC;
- Process related issues, including the publication date for inter-regional transmission charges; and
- The efficiency of the inter-region price signals that would arise from the application of the AEMC's proposal.

Responses to the specific questions posed by the AEMC have been included as an attachment to this response.

Pricing effects of the Rule change

We are concerned that this Rule change proposal is based on a premise that has not yet been tested, nor justified.

We note that the MCE, in its request for the Rule change, is of the belief that "...the potential impact of the proposed Rule change on load customers is initially not expected to be significant, for most

customers”.¹ No evidence of, or justification for, this statement was given. It would greatly benefit all stakeholders, including EnergyAustralia, for any analysis supporting this premise to be subject to further consultation. This would be a normal prerequisite for any Rule change proponent and should apply equally to any Rule change proposed by the MCE.

Without a clear understanding of the price impacts arising from the AEMC’s Rule change proposal, it is very difficult to comment on many aspects of the proposal. Specifically, comments have been requested by the AEMC on:

- The composition of the inter-regional charge;
- The need for transitional arrangements to phase in price impacts;
- The treatment of settlement surpluses; and
- The effect of differing TUoS allocation procedures by TNSPs.

To the extent that the MCE premise is correct, many stakeholders will be indifferent to the proposed Rule and the questions the AEMC raises. However, our concern is simply that the premise may not be correct and the development of policy and rules around inter-regional TUoS pricing should not proceed until the analysis is developed and has been consulted upon.

Our concern on this aspect is heightened by our understanding of the pricing impacts that were observed during the development of the current transmission pricing arrangements by the National Grid Management Council (NGMC), in the early and mid 1990’s. At that time, the original objective was to establish national transmission pricing arrangements that would be independent of jurisdictional boundaries. NGMC analysis indicated that material price impacts *did* arise from the application of inter-region TUoS charges, which is the principal reason they were not adopted at the time. We acknowledge that the composition of generation and load across the national grid has changed since that time and that refinements to the TUoS allocation have been made, including the adoption by some TNSPs of the “enhanced CRNP” allocation method, which does have material pricing effects within regions.²

EnergyAustralia therefore urges the AEMC not to proceed with the current proposal until the requisite analysis of pricing effects has been performed and is made available to inform all parties to this fundamental policy development.

Process matters

On an annual basis, EnergyAustralia is required by clause 6.18.2 of the Rules to prepare a pricing proposal and prices for the use of its network, which include TUoS recovery components. This forms part of a comprehensive disclosure process that is directed at informing and educating our customers on price movements over time and imposes increasing obligations in respect of providing price certainty.

We believe that the AEMC’s proposal will introduce a greater level of price uncertainty, both initially and on an ongoing basis. To address this issue we consider that the publication date for inter-regional transmission charges should be 15 April of each regulatory year which would allow us to provide sufficient notice to customers of likely changes to prices in the forthcoming year.

¹ Ministerial Council on Energy, Rule Change Request - Inter-regional Transmission Charging, February 2010.

² Permitted by clause 6.A.23.3(d)(2) of the Rules.

The logistics of establishing DUoS prices each year are already very challenging, with TNSPs required to publish their prices on 15 May and most DNSPs required to submit their pricing proposals and prices to the AER by 1 May, for a 1 July price change. There can be significant changes to the amount of transmission charge that is required to be passed on to customers, with notification occurring very close and sometimes after the time EnergyAustralia is required to submit a pricing proposal.³ The AEMC's inter-region TUoS arrangements appear certain to exacerbate this situation, in that a TNSP will be unable to finalise its prices until it has calculated, agreed and incorporated inter-region charges to and from adjacent jurisdictions into its prices, before passing these on to DNSPs.

EnergyAustralia therefore strongly advocates the publication of transmission charges by TNSPs at least one month earlier, in able to permit their orderly incorporation into DUoS charges.

Pricing efficiency

We note that the MCE has requested that inter-regional TUoS charges be calculated "as if the relevant interconnection with the adjoining network was a load on the boundary of the region". The AEMC's proposal for a Rule change seeks to implement this request. We believe that the locational component of TUoS is more compatible with the concept of a "load on the boundary of the region".

The locational component of TUoS is intended to influence the consumption patterns of load customers through cost reflective charges. In contrast, the non-locational TUoS component is recovered through a postage stamp charge, with the very objective of not distorting customers' consumption patterns. The major proportion of this non-locational cost is associated with assets serving customers within a region, rather than the small number of assets near the jurisdictional interface, whose locational cost would be allocated to customers in another jurisdiction. Passing on these charges between regions, particularly in respect of sunk assets, would not contribute to "efficient investment in, and efficient operation and use of, electricity services".

EnergyAustralia is therefore not convinced that passing on the non-locational component of TUoS to another region contributes to pricing efficiency or to the market objective.

The need for a more substantive review if material changes to cost allocation between regions is contemplated

As we noted above, our concerns surrounding price efficiency are less of a concern if the MCE is correct in its premise that this Rule change will have no material effect on customers. However, if analysis suggests that proposed changes would significantly affect customers, a wider review of options should be explored.

For example, if the goal of the pricing arrangements is to promote efficient pricing signals, the AEMC could consider demonstrating to customers that it has considered whether there should be a proportional allocation of cost to generators upstream of inter-regional interconnections to provide efficient pricing.

Regional interconnections comprise lengthy, high capacity, high cost transmission assets connecting remote generators to jurisdictional interfaces. However, under the inter-region TUoS proposal, generators do not pay charges for their use of the capacity of shared network assets. Generators in the

³ In a previous Rule change request we noted that in 2008, successive estimates of the transmission price change forced EnergyAustralia to resubmit distribution prices to IPART (together with a request to vary the pricing side constraint by differing amounts) on three occasions.

exporting jurisdiction can make free use of these assets and the entire cost of the assets be borne by the downstream customers in the importing jurisdiction.

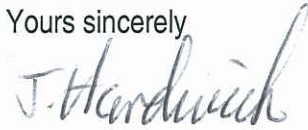
Historically, Rule makers have been reluctant to break the "golden rule" that shared network infrastructure should be paid for by load customers. However, in the case of the SENE proposal, the AEMC accepted that generator charges for shared network infrastructure were appropriate. If there are likely material impacts from changing cost allocation and pricing arrangements, then it may be appropriate for the AEMC to also consider proportional cost sharing between user classes.

To conclude, EnergyAustralia believes the AEMC's current proposal and the associated processes should not be implemented at this time.

Only when sufficient testing of the AEMC's proposal has established the materiality of the pricing impacts on customers, should the detail of this significant policy development be determined.

Should you have any questions in relation to this submission, please contact Ms Jane Smith on 9269 4171.

Yours sincerely,

A handwritten signature in dark ink, appearing to read "J. Hardwick", with a stylized flourish extending from the end.

JOHN HARDWICK

A/Executive General Manager
System Planning and Regulation

Attachment - Responses to AEMC Questions

This attachment responds to the specific questions concerning the implementation of Inter-regional TUoS that the AEMC has raised in its Rule change proposal.

Question 1 What should be the composition of a load export charge?

1.1 As a charge is proposed to be calculated for an export load in the same way as other loads, how should the export load be defined? That is, should an export load be defined as a notional interconnector that joins two regions or should individual connection points be recognised? How does the definition of the export load impact on the calculation of the load export charge and the redistribution of settlement residue amounts as discussed in the following sections of this paper?

The current transmission pricing allocation model applies to each transmission connection point in a region. Where there are interconnections between regions, the points of interconnection are modelled using an equivalent load or generator, which represents the net effect of interconnection flow at that connection point. That flow may take place over multiple circuits to an interconnection point.

For the present, it would be efficient and appropriate for the existing models to be retained, and the costs allocated to these equivalent loads at interconnection points to be allocated to the adjacent interconnected region. Where there are geographically separate points of interconnection, as between NSW and Victoria, the interconnection flows would be separately modelled at each interconnection point and the inter-region TUoS charges aggregated.

It should be noted that the existing regional modelling approach would provide different outcomes to those that would be delivered if all assets and connection points were to be included within a single pricing allocation model. Such a combined approach is likely to produce improved pricing signals through a seamless allocation approach, however we recognise there would be logistic issues associated with its establishment.

As with other aspects of the AEMC's proposal, it is not possible to comment on how specific details of the pricing modelling allocation will affect settlement outcomes until detailed modelling is carried out.

1.2 Do the existing provisions under the Rules provide for cost-reflective price signals in relation to the use of the transmission network by a region that imports electricity from an adjoining region? Do customers in an importing region use the exporting TNSP's services in a similar way to customers within the region?

The existing provisions under the Rules, to wit 6A.23.3(c)(i), which prescribes the pricing allocation for interconnectors, do not provide for cost reflective price signals in relation to inter-regional use of the network. The cost reflective TUoS provisions extend only to the regional boundary. Costs associated with upstream assets involved within the adjacent network are borne by the customers in that network. EnergyAustralia acknowledges that customers within an importing region do make equivalent use of upstream transmission services in the exporting region.

However, in relation to the "use" of the exporting TNSPs interconnecting transmission network this question cannot be fully answered without also considering the use of shared network capacity by generators.

The AEMC's inter-region TUoS proposal perpetuates an issue where lengthy, high capacity, high cost transmission assets connect remote generators to jurisdictional interfaces. Generators can make free use of these assets and the entire cost of the assets be borne by the downstream customers in another jurisdiction.

1.3 What should be the composition of the load export charge that would reflect the use of the transmission network by customers in the importing region? If the charge should include charges for prescribed TUoS services, should both the locational and non-locational component be included?

EnergyAustralia acknowledges that the MCE requested that inter-regional TUoS charges be calculated "as if the relevant interconnection with the adjoining network was a load on the boundary of the region".⁴ The AEMC's proposal for a Rule change seeks to implement this request. However, NEM participants would benefit from quantitative analysis of the impact of such an approach.

The locational component of TUoS is intended to influence the consumption patterns of load customers through cost reflective charges.

In contrast, the non-locational TUoS component is recovered through a postage stamp charge, with the very objective of not distorting customers' consumption patterns. The great majority of this charge is associated with assets throughout the region, rather than assets at regional boundaries associated with interconnections. Passing on these charges between regions, particularly in respect of sunk assets, would not contribute to "efficient investment in, and efficient operation and use of, electricity services".

Question 2 How should a load export charge be calculated?

2.1 Is the proposed load export charge consistent with the current pricing principles under the Rules?

Should the Rule change proceed, the overriding principles concerning cost allocation to intra-region load connections using the CRNP allocation approach are also appropriate for interconnected loads. However, again, NEM participants would benefit from quantitative analysis being undertaken to determine the impacts.

As the AEMC has identified, specific sections of the pricing principles set out in clause 6A.23 of the Rules will need to be modified, to facilitate the AEMC's proposal on inter-regional TUoS.

2.2 What are the differences in the current pricing methodologies adopted by TNSPs and how would any differences need to be addressed? Given that, under the proposed Rule, TNSPs would levy charges on each other, what would be the impact of differences in pricing methodologies of those charges?

2.3 What level of discretion should be given to TNSPs in calculating charges? Should any specific provisions be made to account for potential differences in pricing methodologies?

It is not possible to provide a definitive answer to these questions in the absence of numeric analysis of the effect of the AEMC's pricing proposal and alternative "what-if" scenarios, where the pricing allocation approaches in interconnected jurisdictions were altered. The price impacts arising from alternative cost allocation methodologies are certainly material within regions. In our opinion, and

⁴ Ministerial Council on Energy, Rule Change Request - Inter-regional Transmission Charging, February 2010, p. 2.

contrary to the MCE, they are also expected to be material between regions, but at this stage have not been identified.

In the likely event that the price impacts arising from changes to the TUoS allocation approach are material, a degree of prescription on the cost allocation approaches used by individual TNSPs will be necessary.

The AEMC is requested to undertake this analysis and publish the outcomes, to allow interested parties to make informed comment on this aspect of the proposed Rule change.

2.4 How prescriptive should the pricing requirements for a load export charge be? For example, should the Rules specify the types of assets to be included? Should the calculations for the load export charge be based on gross or net interconnector flows?

The assets involved in determining the load export charge may be material in determining the magnitude of that charge. NEM participants would benefit from quantitative analysis being undertaken to determine the impacts.

The Rules should specify the types of assets to be included in the cost allocation.

The current pricing allocation used by NSPs uses equivalent loads and generators at the points of interconnection, to represent the net interconnector flow to/from the interconnected region. The cost allocation outcome of such modelling would significantly differ from the alternative of using a single, combined jurisdiction model, which would allocate costs on a holistic basis across two or more regions. Again, the AEMC is requested to undertake analysis of this aspect and publish the outcomes, to allow interested parties to make informed comment.

Question 3 How should a load export charge be recovered by the importing TNSP?

3.1 On the basis that the load export charge should promote more cost reflective price signals, what should be taken into consideration in determining how the load export charge should be recovered?

For the charges to intra-regional loads, the locational component of TUoS is required to be recovered through a cost reflective charge, based on network demand. This requirement is imposed by clause 6A.23.4(e) of the Rules.

An equivalent provision needs to apply to the locational component of inter-regional TUoS charges. An obligation also needs to be placed on the TNSP in the importing region, to pass on that component of the charge in a cost reflective manner to DNSPs in the region.

The Rules provisions for DNSPs in clause 6.18.5(b) already impose requirements on the charging parameters of distribution tariffs to end-use customers, including TUoS recovery charges.

In the response to Question 1.3, EnergyAustralia has proposed that postage stamp charges should not be recovered between regions. However, if the AEMC does proceed with this element of inter-regional TUoS charging, economic price signals would be preserved only if inter-region postage stamp price components were recovered on the same basis in the importing region.

3.2 How should any auction proceeds be distributed to customers in an importing region?

EnergyAustralia notes that the MCE has requested that inter-regional settlements surpluses be returned to customers via the non-locational component of TUoS, rather than the locational component, as currently required by clause 6A.23.3(c)(1) of the Rules.⁵

In principle, EnergyAustralia would support such an improvement, since the year on year variation of settlements surpluses leads to instability in the cost reflective components of TUoS charges. However, in common with other elements of the AEMC's proposal, NEM participants would benefit from quantitative analysis being undertaken to determine impacts for customers.

Question 4 Would introducing a load export charge impact MNSPs?

4.1 How does the proposed load export charge impact on customers in regions that import electricity from a region interconnected by an unregulated interconnector? What, if any, specific provisions should be considered as a part of this Rule change process?

It would be inappropriate for the presence of a MNSP to act as a "circuit breaker" to the allocation of load related charges between NEM regions, where inter-regional flows were carried both by the MNSP and prescribed transmission assets.

This question is of particular significance to Tasmania, as a primarily importing jurisdiction that is connected to the mainland via Basslink, which is a MNSP.

Notwithstanding EnergyAustralia's comments on the materiality of the TUoS charge to importing jurisdictions and the cost reflectivity of the charge, in this instance a uniform transmission pricing arrangement should provide the same TUoS pricing signals to Tasmania for the use of the Victorian system as would apply to another interconnected jurisdiction. It would be inappropriate for the presence of Basslink (or any other MNSP) to inhibit the transfer of a TUoS charge between NEM regions.

Arrangements will therefore required, whereby either:

- The MNSPs, as interconnected parties, receive TUoS charges from the TNSP in the exporting NEM region and are permitted to recover these charges from the TNSP in the importing region; or
- Alternatively, inter-region TUoS charges are settled directly between the TNSPs connected to a MNSP.

The second of these two alternatives would be more efficient from the perspective of transaction costs and administrative complexity.

Question 5 What factors would need to be considered to provide for administrative efficiency?

5.1 What are the administrative impacts on CNSPs by introducing new type[s] of payments between CNSPs? For example, how often should payments be made? Should the payments be made on a gross or net basis? Would TNSPs be exposed to a new credit risk and, if so, how should the risk be managed?

EnergyAustralia acknowledges that the additional obligations imposed by the proposed Rule change will fall principally upon the CNSP, which in NSW is TransGrid. However, as a DNSP, EnergyAustralia

⁵ MCE, February 2010, p. 3.

faces increasing obligations and expectations to provide its customers future price certainty and stability. This is difficult to achieve with the existing administrative timetable in the Rules.

The new obligations imposed by the AEMC's Rule change will exacerbate the already complex and unsatisfactory annual process by which TUoS charges are not officially published by TNSPs until 15 May but must be factored into most DNSP's pricing proposals and DUoS charges by 1 May each year. EnergyAustralia is on the record as having advocated the publication of TUoS prices prior to 15 May each year. This additional requirement for coordination between TNSPs on inter-region charges will result in an even greater level of uncertainty in the TNSP's preliminary estimates of TUoS charges and potentially greater variances taking place in DNSPs' TUoS recovery charges.

If the DNSP's TUoS recovery charges are set using out of date information, there will inevitably be greater annual variation in these charges as the discrepancies subsequently revealed are corrected through the overs and unders mechanism. Fluctuations in pricing detract from the efficacy of their signalling to influence customer behaviour, and are to be avoided if at all possible. It is therefore of great importance that the transmission cost recovery tariffs are set using up to date information which aligns with the transmission prices for the same period.

The current arrangements do not facilitate an orderly process for the DNSPs to establish their transmission recovery tariffs and incorporate them in pricing proposals and the additional administrative complexity introduced by the AEMC's proposal to establish inter-regional TUoS charges will further hamper this process.

EnergyAustralia therefore proposes that the TNSPs be required to exchange inter-regional TUoS charges and publish their charges at least one month prior to 15 May.

As to the matter of credit risk between TNSPs, EnergyAustralia cannot comment, as the materiality of the inter-regional TUoS payments has not been established by the AEMC.

Question 6 What would be the appropriate level of prescription and transparency for any new pricing provisions?

6.1 Are there other factors relating to the level of prescription and transparency that have not already been considered under the other questions raised? For example, should payment terms and the billing period be specified for payments between CNSPs?

As a general principle, the payment terms and default arrangements between TNSPs should be a matter for commercial negotiation between them.

6.2 In regions where there are multiple TNSPs, does the way in which a CNSP bill and receive payments from TNSPs within that region need clarification and/or prescription?

TransGrid is the coordinating NSP in NSW and from EnergyAustralia's perspective, the existing arrangements function satisfactorily. We therefore do not believe that greater prescription or clarification of these arrangements is required. However, we would like to provide further comment if the AEMC were to propose additional administrative requirements for the pricing proposal process which, as we have outlined, is subject to considerably truncated timelines.

6.3 Should a load export charge be able to be implemented without the requirement for the AER to produce new pricing methodology guidelines? If so, would any clarifications need to be included in the new Rules?

The AER's existing transmission pricing methodology guidelines do not appear to require modification to enable the recovery of inter-regional TUoS charges.⁶

Question 7 What transitional provisions should be considered to ensure stability and regulatory certainty?

7.1 Implementing a load export charge would likely result in the one-off redistribution of transmission service charges. This redistribution may impact some customers more than others. Should any specific provisions be put in place to manage the potential change in charges?

The AEMC has not identified the magnitude of the one-off redistribution of transmission service charges or its effect upon different classes of customers. Quantitative analysis, if it has not already been undertaken, should be done before further consultation is undertaken.

Contrary to the MCE's premise, the redistribution could be material in its effect and therefore specific transitional provisions will be required, if it is decided to proceed with the proposal when those pricing impacts are understood.

The nature and timing of appropriate transitional provisions cannot be established without knowledge of the extent of the cost redistribution and its pricing impacts on different customer classes.

It should be noted that transitional provisions for the introduction of inter-region TUoS could be implemented at the transmission level, at the distribution level, or some combination of the two. Their interaction with existing pricing constraints for both transmission and distribution charges will also need careful consideration, to ensure that:

- The impacts on transmission and distribution connected customers are balanced; and
- Each TNSP or DNSP is not prevented from recovering the regulated revenue for its prescribed services.

7.2 Would it be feasible to implement the proposed load export charge by 1 July 2011? What factors should be taken into consideration to determine the implementation date? What transitional provisions would need to be in place to allow any new provisions to be implemented as soon as practicable while ensuring that regulatory certainty is maintained?

EnergyAustralia does not believe that the proposed inter-jurisdiction pricing arrangements could reasonably be implemented by 1 July 2011. Elsewhere in this response, we have stressed the need for modelling to be undertaken to identify the pricing impacts of the proposal before the policy details and the date of its introduction are established.

⁶ Australian Energy Regulator, Final - Electricity transmission network service providers Pricing methodology guidelines, October 2007.