

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Matter No. ERC0117

Dear Sir

Re: Matter No. ERC0117 - National Electricity Amendment (Application of Dual Marginal Loss Factors) Rule 2011

I refer to the Rule change proposal by AEMO on the above matter, and the associated Guidance Paper, prepared by the AEMC. TransGrid appreciates the work carried out by both organisations in trying to address this issue. Based on the analysis contained in these papers (particularly that based on the data in Tables 1 and 2 of the Rule change proposal) TransGrid supports the proposed changes to the setting of average marginal loss factors within the wholesale electricity market. This analysis appears to enhance the National Electricity Objective and is a proportionate response to concerns about inaccurate loss factors.

TransGrid's recent experience suggests that, in the NSW region, movements in intra-regional residues have impacted significantly on transmission prices causing material and unpredictable input cost movements for larger customers. This is difficult for these customers to manage, particularly when they are themselves operating in a competitive market for their product.

TransGrid is also aware that Snowy Hydro has been looking at this issue and may be in a position to provide additional relevant analysis of the impact of this Rule change, which may have a bearing on the assessment of the benefits. It should be noted that TransGrid's support for this Rule change is predicated on fully understanding and confirming the data provided by AEMO.

As recognised in the AEMC's guidance paper the setting of loss factors impacts on the value of intra-regional residues and, consequently, transmission charges. The value of intra-regional settlement residues accumulating in the market in the NSW region in 2008-09 was around \$27 million. However, in 2009-10 the intra-residues in the same region were around minus \$8 million. Because this 'turnaround' is linked to a very small number of high priced market events it is uncertain, at this time, as to whether this is representative of future outcomes.

A reversal of \$35 million in intra-regional residues accruing in NSW a year had two impacts on transmission charges in that region. The shortfall in transmission revenue of \$35 million required an increase of the same amount of transmission revenue to be recovered in NSW in 2010-11. In addition, the value of intra-regional residues to accrue in 2010-11 is uncertain but was forecast to fall by a comparable amount on the assumption of a similar set of market events in that year. As noted above the validity of this assumption will become clearer over time. Together these two impacts increased in NSW transmission charges by around 7% from 2009-10 to 2010-11.

As the AEMC correctly points out this increase is recovered from customers in a way that has no relationship with each customer's impact on system losses. Under the transmission pricing arrangements the intraregional settlement residue shortfalls are recovered from customers in

proportion to their historical average consumption whereas loss creation is very much more related to location and timing of actual consumption. That is, the price paid by customers for system losses has no relationship with the marginal cost of loss creation. Clearly, if the Rule change proposal can be shown to result in more accurate average marginal loss factors across the range of likely market conditions this price distortion is reduced. As already noted, based on the analysis carried out by AEMO, this is clearly the case.

In summary, on the basis of the evidence provided to date, the Rule change proposal results in more efficient price signalling in the market and to customers of transmission services. On this basis it advances the achievement of the National Electricity Objective. The proposal also appears to be no more complex or costly to implement than is necessary to substantially address the pricing problem i.e. it is a 'proportionate' response.

Therefore, subject to the provision of further analysis to the contrary, TransGrid supports the proposed Rule change.

Yours sincerely

Philip Gall 10/2/2011

Philip Gall
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