19 December 2013

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

Via website: www.aemc.gov.au

Dear John

**Response to the Distribution Network Pricing Arrangements Rule change consultation paper**

Grid Australia welcomes the opportunity to respond to the Distribution Network Pricing Arrangements Rule change consultation paper. Grid Australia members are responsible for the annual calculation of transmission prices for distribution and direct connect customers throughout the National Electricity Market.

Grid Australia lodged a submission[1] on the earlier Annual Pricing Arrangements Rule consultation paper[2]. This submission principally addressed the compressed time frame of the proposal and consequent uncertainty and volatility of transmission prices from year to year.

As the Distribution Network Pricing consultation has maintained the proposal to publish transmission prices by 15 March each year, two months earlier than is currently the case, the issues raised in the earlier submission remain relevant.

> "…the issue raised by IPART may be local to NSW, and therefore better addressed administratively in that jurisdiction, were the Commission to prefer a NEM-wide Rule change, Grid Australia considers that. In light of the volatility risks outlined above, a more appropriate timeframe would be to require transmission prices to be published on 15 April rather than 15 March. This would allow less forecasting risk in relation to two of the key drivers of transmission price volatility, namely, inter-regional transmission charges and

1 Grid Australia submission on Annual Network Pricing Arrangements Rule 2013 Consultation Paper (ERC0149) – 5 July 2013

2 AEMC 2013, Annual Network Pricing Arrangements, Consultation Paper, 6 June 2013, Sydney

> settlement residues. It should also allow adequate time to ensure that co-ordinating TNSPs can prepare accurate network models on which to base their pricing."[3]

Grid Australia maintains the position that a proportionate response to the issues raised in the consultation paper is for publication date for transmission prices to be brought forward to no earlier than 15 April each year.

While Grid Australia does not have a position on the merits of using long-run marginal cost (LRMC) for pricing purposes (as proposed in the Consultation Paper), it does have concerns with the lack of transparency of transmission locational price pass-through to large customers in some jurisdictions. This is addressed in the attachment, which sets out Grid Australia's response to the relevant questions from the Commission's Consultation Paper.

Please do not hesitate to contact Bill Jackson on (08) 8404 7969 or jackson.bill@electranet.com.au if you wish to discuss any matter raised in this submission.

Yours sincerely

Rainer Korte

Rainer Korte
**Chairman**
**Grid Australia Regulatory Managers Group**

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[3] Grid Australia submission, 5 July 2013, p.4.

**Response to selected Consultation Paper questions**

**Question 4: What level of information on network tariff structures and network tariff pricing levels should be included in a network tariff structures document to assist retailers and consumers to understand and respond effectively to changing prices and structures over the regulatory period?**

Grid Australia considers that for large customers, being those over 10MW or 40GWh per annum, the information specified in clause 6.23 of the Rules should be required to be available. In order to achieve this, the Pricing Structures Statement (PSS) or similar instrument should address the methodology for deriving this information.

**Question 8: Should DNSPs be required to consult with stakeholders before submitting their proposed pricing structures statement to the AER for approval through the regulatory determination process?**

TNSPs could be considered one of the stakeholder groups that the DNSPs consult with on their PSS. TNSPs would be expected to take particular interest in the methodology for pass-through of transmission locational signals to large customers per clause 6.23 of the Rules.

**Section 8.1.2: Potential constraints on bringing forward the annual pricing process**

Grid Australia notes that the consultation paper does not ask a question regarding the constraints on bringing forward the annual pricing process. The consultation paper does not adequately address the concerns raised by Grid Australia in its previous submission and incorrectly identifies CPI as the fundamental impediment to early publication.

As noted in our previous submission, the key areas of uncertainty and factors that influence timing relate to:

- Preparation of network models for co-ordinating TNSPs;
- Inter-regional transmission charging; and
- Interregional settlements residue auction proceeds, negative interregional settlements residue and intraregional settlements residue (settlements residue)

Each of these elements is again addressed in turn.

<u>Preparation of network models for co-ordinating TNSPs</u>

Co-ordinating TNSPs in a region must update not only their own network models and asset information as an input to transmission pricing, but also the network and asset information from other TNSPs within their region. This process necessarily involves an iterative process between those TNSPs.

Figure 1 below shows this process incorporated into the overall transmission price-setting process.

Inter-regional transmission charging

The Rule change proposal and Consultation Paper do not appear to fully reflect the new arrangements associated with the introduction of inter-regional charging. The requirement to publish inter-regional charges by 15 March, beginning in 2015, will of itself result in the entire transmission pricing process commencing approximately two months earlier than is currently the case. This will result in a greater reliance on forecasts for key inputs to the transmission pricing process and associated volatility in transmission charges. Thus, in order to retain inter-regional charging under IPART's proposal, the publication of inter-regional charges would need to be brought forward to at least 15 January. This would significantly exacerbate the impact of IPART's proposal on transmission pricing cost reflectivity.

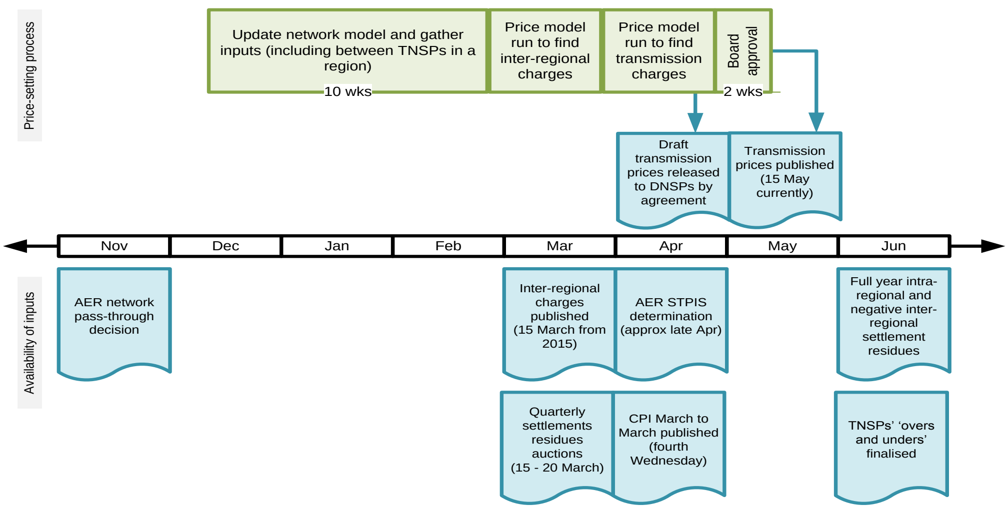
Settlements residue

Settlements residue related actuals and forecasts are a key input into the transmission price-setting process and can materially impact transmission pricing outcomes. Positive inter-regional settlements residues are auctioned quarterly by the Australian Energy Market Operator (AEMO), while negative inter-regional settlements residues, and positive and negative intra-regional settlements residues, are calculated and published weekly by AEMO. Notably, AEMO normally makes the results of the March positive inter-regional settlements residue auctions available between 15 and 20 March.

As part of transmission price-setting, TNSPs must forecast these inputs both to the end of the current financial year and for the entire next financial year. If TNSPs are required to forecast for longer periods for both intra-regional and inter-regional settlement residues it will result in increased volatility in transmission prices for distribution customers and direct connect customers. As noted by the AER in its submission on the earlier Annual Pricing Arrangements Rule consultation paper[4], the increased use of forecasts will also create additional cash flow risks for service providers.

4 AER Submission to IPART proposed rule change, Annual Network Pricing Arrangements, 5 July 2013

**Figure 2 Transmission price setting process and inputs**




Notes
1. Durations of processes are approximate only
2. The method for incorporating inter-regional transmission charges in the overall transmission price-setting process is speculative, as the Rule change has not yet come into effect.
3. Green boxes indicate processes, while blue rectangles with waved bottom indicate publications or outputs

<u>Other issues – CPI and STPIS</u>

The Australian Bureau of Statistics publishes the CPI figures for March to March (currently specified as a pricing input by the AER in the majority of TNSP revenue determinations) around the fourth week of April. The March quarter CPI is also used in Transmission Connection Agreements (TCAs) with customers.

As noted earlier, using a forecast March quarter CPI (with a consequential true-up error correction in the subsequent year) is not considered a material impediment to earlier publication of transmission prices. The misalignment between forecast and actual is likely to result in price uncertainty of less than 0.25%. A move to use December to December CPI is also not proportionate to the perceived problem and may require consequent changes to transmission connection agreements (TCAs), which frequently specify March quarter CPI.

At present TNSPs submit their annual service targets performance incentive scheme (STPIS) reports to the AER at the end of January each year. The AER generally publishes its decision on TNSP annual STPIS reports in late April each year.

The timing of the STPIS outcome versus the pricing publication date is unlikely to lead to material price volatility. However, a move to financial year assessments for the STPIS, as raised as a possibility by the AER in its IPART submission, may have merit.

**Question 40: Should network tariffs reflect transmission pricing signals? If so, what would the most appropriate way to achieve this for different types of network customers?**

Yes, network tariffs should reflect transmission pricing signals.

Transmission charges must already be set to encourage efficient network investment

As the AEMC notes, TNSPs are 'obligated to set efficient charges through their approved pricing methodologies, currently'[5].

Transmission charges must send pricing signals to promote efficient outcomes, as well as allow means for the TNSP to fully recover its allowed regulated revenues. To this end, there are two broad types of transmission charges:

- a **locational** component, which varies in accordance with a customer's location and a customer's usage of the network, in order to send signals about the future cost of network services.
- a **non-locational component**, allocated on a 'postage stamp' basis, in order to recover the remainder of TNSPs approved prescribed transmission revenue including, but not limited to, residual sunk costs of the network.

The locational component is required to be allocated to connection points "on the basis of the estimated proportionate use of the relevant transmission system assets"[6], with the cost reflective pricing methodology (CRNP) and the modified CRNP being two permitted means to do this.

Alternative means of allocating these costs are permitted per clause 6A.23.3 (d)(2) which states:

> "An alternative allocation to each component that is based on a reasonable estimate of future network utilisation and the likely need for future transmission investment, and that has the objective of providing more efficient locational signals to Market Participants, Intending Participants and end-users."

DNSPs are currently not required to pass on TNSP pricing signals, although some jurisdictions have required this for large customers.

The consultation paper notes that the NER is silent on addressing how DNSPs should structure network tariffs in an efficient and cost-reflective manner to recover Transmission Use of System (TUOS) charges paid to TNSPs.

The absence of a requirement in the NER to pass on these pricing signals in an efficient, cost reflective manner leaves open to the DNSP how to recover transmission charges from customers. This runs the risk that distribution customers may not see locational pricing signals, and could therefore be prevented from making efficient locational and consumption decisions. Transmission locational signals are of particular importance for new large customers seeking to locate in higher cost areas of the transmission system.

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[5] AEMC 2013, *Distribution Network Pricing Arrangements*, Consultation Paper, 14 November 2013, p.68

[6] Rules clause 6A.23.3 (c)(1)

<u>Clause 6.23 allows for some transparency of transmission charges for large customers.</u>

Large consumers may request disclosure of transmission and distribution charges, under clause 6.23(a) of the NER. On request, DNSPs must provide a disclosure statement providing 'the separate components of the designated pricing proposal charges and distribution use of system charges comprised in the charges for electricity supplied to the Distribution Customer's connection points.'

Grid Australia is concerned that the provision requires a consumer to request this information and that the methodology for pass-through is not subject to review by an external party, in particular, the applicable TNSP.

<u>Optimal pass through of transmission charges may vary by customer type</u>

Grid Australia considers that transmission charges should be directly and transparently passed through to large customers. One option for affecting this result would be to modify the requirement for large customers to request TUOS pass-through and instead mandating the provision of the information specified in NER clause 6.23 together with a requirement that the proposed methodology for calculating this pass-through be addressed in the PSS.

Jurisdictional instruments, transactional and equity issues may prevent similar pass through being possible for medium and small customers. Any decision to pass locational signals though to these classes of customers should be based on an economic cost benefit assessment.

**Questions 41 and 42: Is the change to a mandatory requirement to group customers into tariff classes likely to achieve the desired outcomes? Is the change to a mandatory requirement to group customers into tariff classes likely to result in inconsistencies within the NER or with any jurisdictional instruments or requirements?**

Changes to grouping of customers for tariff classes must align with any changes to improve transparency of transmission charges for various customers (see Question 40).