



Australian Energy Market Commission

Draft Rule Determination

**National Electricity Amendment (Cost
Allocation Arrangements for Transmission
Services) Rule 2008**

Rule Proponent
National Generators Forum

28 August 2008

Signed:

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Chairman

For and on behalf of
Australian Energy Market Commission

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About the AEMC

The Council of Australian Governments, through its Ministerial Council on Energy, established the Australian Energy Market Commission (AEMC) in July 2005 to be the Rule maker for national energy markets. The AEMC is currently responsible for Rules and policy advice covering the National Electricity Market. It is a statutory authority. Our key responsibilities are to consider Rule change proposals, conduct energy market reviews and provide policy advice to the Ministerial Council as requested, or on AEMC initiative.

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Contents

Abbreviations	iv
Summary	v
1 The NGF Rule change proposal	1
1.1 Background	1
1.2 Context	1
1.3 Problem to be addressed by the Rule proposal	2
1.4 Rule proponent's proposed solution	3
1.5 Consultation	4
1.6 Consultation on draft Rule determination	5
2 Draft Rule determination	7
2.1 Commission's Draft Rule determination	7
2.2 Commission's considerations	7
2.3 The Commission's power to make the Rule	8
2.4 Differences between the Rule proposal and Draft Rule	9
3 Commission's assessment approach	11
3.1 Methodology	11
3.2 Rule making test and the National Electricity Objective	11
3.3 Form of regulation factors and revenue and pricing principles	12
4 Assessment of grandfathering transmission services	15
4.1 Issue raised by the NGF	15
4.2 Description of NGF's Rule proposal	15
4.3 Submissions	16
4.4 Commission's analysis of the issues	18
5 Cost allocation arrangements, removal of assets from the RAB and ring-fencing	31
5.1 Cost allocation arrangements	31
5.2 Removal of assets from the regulatory asset base	40
5.3 Application of Transmission Ring-Fencing Guidelines to cost allocation	42

Abbreviations

AARR	Aggregate Annual Revenue Requirement
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
EUAA	Energy Users Association of Australia
MCE	Ministerial Council on Energy
MEU	Major Energy Users Group
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NGF	National Generators Forum
RAB	Regulatory Asset Base
Rules	National Electricity Rules
TNSP	Transmission Network Service Provider
TUOS	Transmission Use of System

Summary

On 18 January 2008, the National Generators Forum (NGF) lodged a Rule change proposal (Rule proposal) with the Australia Energy Market Commission (Commission) regarding the cost allocation arrangements for transmission services.^a

The NGF's Rule proposal aims to address an area in the National Electricity Rules (Rules) that it believes leads to the shifting of costs from historically shared transmission services to entry or exit services. This shift, it believes, is a result of a re-allocation of costs or a network reconfiguration undertaken for the benefit of network users generally.

The Rule proposal focuses on the following areas:

- clarifying the grandfathering provisions under clause 11.6.11 of the Rules;
- preserving the cost allocation methodology in respect of grandfathered services;
- preventing the removal of assets from a transmission network service provider's regulated asset base (RAB) due to asset reconfigurations; and
- clarifying interaction of transmission ring-fencing guidelines and cost allocation principles.

In accordance with section 99 of the National Electricity Law (NEL), the Commission has determined to make with amendments a draft Rule in relation to the proposed Rule (Draft Rule). As the Draft Rule includes amendments to the NGF's proposed rule, it is a more preferable Rule. The Draft Rule aims to improve the application of the grandfathering provisions with respect to the current Rule and the NGF's Rule proposal.

The Commission is satisfied that, having regard to the issues raised by the NGF, that the more preferable Rule will, or is likely to, contribute better to the achievement of the National Electricity Objective (NEO). The Commission considers that the Rule will satisfy the NEO as it:

- is consistent with the principles of good regulatory design;
- clarifies of the meaning, workability and implementation of the grandfathering provisions and cost allocation arrangements, thereby enhancing regulatory certainty;
- provides a mechanism for the end of grandfathering that is cognisant of the existing commercial relationships between transmission network users and transmission network service providers;

^a National Generators Forum, *Proposal for Rule on Transmission Entry and Exist Charges*, 18 January 2008 (Rule proposal).

- is fundamentally sustaining the Commission's policy intent with regard to the transitioning, over time, of prescribed transmission connection services to *negotiated transmission services* and their removal from the regulatory asset base; and
- clarifies the application of *Cost Allocation Principles* to grandfathered 'prescribed connection services' making them consistent with a shallow connection pricing approach adopted by the Commission.

In making this draft Rule determination, the Commission has had regard to a number of factors including the Rule proposal, stakeholder submissions and the requirements under the NEL.

The Commission invites submissions on this draft Rule determination by 10 October 2008.

In accordance with section 101 of the NEL, any interested person or body may request that the Commission hold a hearing in relation to the Draft Rule determination. Any request for a pre-determination hearing must be made in writing and must be received by the Commission no later than 5 September 2008.

Submissions and requests for a hearing may be sent electronically to submissions@aemc.gov.au or by mail to:

Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1255

1 The NGF Rule change proposal

1.1 Background

On 18 January 2008, the National Generators Forum (NGF) lodged a Rule change proposal with the Australia Energy Market Commission (Commission) regarding the cost allocation arrangements for transmission services (Rule proposal).¹

In its Rule proposal the NGF has sought to address what it sees as ambiguities in the provisions in the National Electricity Rules (Rules). That is, clause 11.6.11 of the Rules, which grandfathers as *prescribed transmission services*, certain *connection services* which would otherwise be categorised as *negotiated transmission services*.² The NGF considers that these ambiguities can result in the costs of *shared transmission services* being allocated to *prescribed entry services* and *prescribed exit services* (in this Draft Rule determination, referred to collectively as 'prescribed connection services'). The NGF considers this to be inappropriate and, accordingly, requests changes to grandfathering provisions to preserve the costs of prescribed connection services as at the commencement of the *National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006 No. 18* (Revenue Rule).³

1.2 Context

Under section 35 of the National Electricity Law (NEL) the Commission was required to review the regulation of electricity transmission revenue and pricing.

Following a substantial review, in November 2006 the Commission published the Revenue Rule together with a final Rule determination⁴ (Revenue Determination) which provides the Commission's reasoning. The Revenue Rule continued direct revenue regulation of shared transmission services provided by *Transmission Network Service Providers* (TNSPs) in recognition of the need to manage the associated market power. The Revenue Rule also established incentives for the competitive or negotiated supply of transmission services.

In the Revenue Rule, the Commission codified regulatory processes to provide better balance, certainty and transparency compared with previous practice. The Revenue Rule also provided guidance to the Australian Energy Regulator (AER) in relation to the criteria to be applied by the AER when exercising discretions conferred on it under the Rules.

¹ National Generators Forum, *Proposal for Rule on Transmission Entry and Exist Charges*, 18 January 2008 (Rule proposal).

² Clause 11.6.11 of the Rules. Terms used in italics have the same meaning as they do in the Rules.

³ The *National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006 No18* commenced operation on 16 November 2006.

⁴ AEMC 2006, *National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006, Rule Determination*, 16 November 2006 (Revenue Determination).

In December 2006, the Commission published the *National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No. 22 (Pricing Rule)*. The Pricing Rule recast the regulatory framework for the pricing of *prescribed transmission services* by setting out principles to be used for developing pricing methodologies.

Chapter 11 of the Rules sets out arrangements for transitioning transmission revenue regulatory arrangements to the new the Chapter 6A environment. These arrangements include grandfathering assets used (or committed to be constructed) for the provision of certain *connection services* as at 9 February 2006 as assets for the provision of *prescribed transmission services* under Chapter 6A.

1.3 Problem to be addressed by the Rule proposal

The primary objective of the Rule proposal is to prevent the shifting of assets (and consequently costs) from *shared transmission services* to providing connection services as a result of reallocating costs or a network reconfiguration that may benefit network users generally. The NGF believes that the ability to shift assets creates uncertainty. In addition, there is potential for such a reallocation to cause price shocks to the detriment of generators. It considers this to be an unintended outcome of clause 11.6.11.

According to the NGF, the main issues to be addressed to ameliorate this problem are:

- Clarification of grandfathering provisions in clause 11.6.11: The grandfathering provisions in clause 11.6.11 are ambiguous and open to interpretation, particularly where the use of an asset changes over time.
- Cost allocation arrangements: *Connection services* may be subject to inefficient cost allocation from historically shared assets. There is a lack of consistency, in terms of cost allocation, between new and existing *connection services*. That is, new or reconfigured *connection services* cannot be liable for costs from historically shared assets whereas existing *connection services* can.⁵ The NGF believes that this is inconsistent with the *Cost Allocation Principle* in Chapter 6A which prevents the reallocation of costs from *prescribed transmission services* to *negotiated transmission services* (that is, connection services).
- Removal of assets from regulatory asset base (RAB): Under clause S6A.2.3, the AER may remove the value of an asset from the RAB at a regulatory reset, undermining clause 6A.19.2(7). This is because, the NGF assumes, following a unilateral reconfiguration of the transmission system by the TNSP and once an asset value is removed from the RAB ‘...the service provided by that (previously grandfathered) asset would only be characterised as a negotiated service, leaving the network user liable to the full cost of the asset’.⁶ Accordingly, this increases the level of investment risk.

⁵ Rule proposal, p.6.

⁶ Rule proposal, p.11.

- Application of *Transmission Ring-fencing Guidelines*: One of the cost allocation principles indicates that the method of cost allocation for transmission services should be consistent with the *Transmission Ring-Fencing Guidelines*⁷. Similarly Rule 6A.21 does not clearly distinguish between the functions of those Guidelines and the *Cost Allocation Principles*.⁸ Accordingly, these anomalies should be addressed.

1.4 Rule proponent's proposed solution

In the Rule proposal the NGF has sought to make four substantive changes to the Rules.⁹ They are summarised below:

- Clarify that the grandfathering provisions in clause 11.6.11 apply to 'prescribed connection services' provided at a point-in-time (as at 16 November 2006) that are being provided by particular assets (in the regulatory asset base as at 9 February 2006). Under this 'point-in-time services approach', any new connection services that result from the reconfiguration of shared assets would be classed as *negotiated transmission services* rather than *prescribed transmission services*. (Therefore under a reconfiguration, the assets relating to the new negotiated service cannot be reallocated to the 'prescribed connection services'). As such the TNSP could not reallocate costs associated with assets used to provide *prescribed transmission services* to *negotiated transmission services*. This would avoid price shocks for generators.
- The cost allocation position prior to the commencement of Chapter 6A would be preserved as an upper limit on costs to prescribed connection services. Only fully dedicated assets could be classified as connection assets for which costs were recoverable through prescribed connection service charges. Any shortfall resulting from the limit of the costs to be allocated to prescribed connection services would be reallocated into *prescribed transmission use of system services* (TUoS) and *prescribed common transmission services*. This would ensure no revenue shortfall for the TNSP.
- Prevent removal of assets from the RAB by the AER as a result of a reconfiguration of the transmission system if the relevant *transmission network user* (or group of users) has not consented and has not unreasonably refused consent.¹⁰ This addresses the issue that a reconfiguration might result in an asset that has previously provided *prescribed transmission services* being reclassified as an asset providing *negotiated transmission services*, and such would be subject to a different charging regime possibly resulting in higher prices for generators.

⁷ Clause 6A.19.2(6) of the Rules.

⁸ Rule proposal, pp. 5-12.

⁹ Rule proposal, pp. 3- 4.

¹⁰ In this situation refusal is deemed not to be unreasonable if network charges are likely to increase by five per cent.

- Amend provisions in the Rules to make it clear that the *Transmission Ring-Fencing Guidelines* do not affect the need for, and extent of, the allocation of costs between transmission services.

1.5 Consultation

Under section 95 of the NEL, on 3 April 2008 the Commission notified its intention to commence the Rule change process and initial consultation on the Rule proposal. Submissions closed on 2 May 2008.

The Commission received five submissions on the Rule proposal in the initial consultation round. The submissions are available on the AEMC website. Initially, submissions were received from:

- Grid Australia (Grid Australia initial submission);
- Major Energy Users Group (MEU); and
- Energy Users Association of Australia (EUAA).

A further two submissions were received after the closing date from Grid Australia (9 July 2008) (Grid Australia supplementary submission) and the NGF (18 July 2008) (NGF submission).

The Commission published two notices under section 107 of the NEL to extend the time for publication of this draft Rule determination so as to have adequate time to consider these additional submissions from Grid Australia and the NGF.

The MEU and EUAA do not support the NGF's proposal to preserve the cost positions for prescribed connection services as at the commencement date of the Revenue Rule.¹¹ These respondents consider aspects of the NGF's proposed cost allocation arrangements to be inequitable. The MEU and EUAA focus on the need for costs between shared and connection services to be allocated on an equitable basis.

In its initial submission, Grid Australia agrees that the grandfathering provisions are ambiguous. However, it has expressed concern that the Rule proposal would not adequately address broader issues such as the consequences of the replacement of grandfathered assets providing prescribed connection services. Grid Australia regards the NGF's proposal as an overly complex approach to addressing the cost allocation arrangements for grandfathered services.¹²

The Grid Australia supplementary submission proposes an alternative approach to the NGF Rule proposal to allow for the transitioning of prescribed connection

¹¹ Major Energy Users, *Cost Allocation Arrangements for Transmission Services*, 16 May 2008 (MEU submission). Energy Users Association of Australia, *Request for a Rule Change – Cost Allocation Arrangements for Transmission Services*, 2 May 2008 (EUAA submission).

¹² Grid Australia, *Cost Allocation Arrangements for Transmission Services – Response to NGF Rule Change Proposal*, 2 May 2008 (Grid Australia initial submission).

services to *negotiated transmission services*. Grid Australia has suggested that assets replaced on a like-for-like basis continue to be grandfathered. Grid Australia proposes that the expiry of *connection agreements* be used to trigger the end of grandfathering for the relevant prescribed connection service.¹³

The NGF has responded to Grid Australia's alternative proposal.¹⁴ It does not support the use of *connection agreements* as a trigger for grandfathering of a service to end or the proposed reference to asset values to calculate charges for grandfathered prescribed connection services.

1.6 Consultation on draft Rule determination

The Commission invites submissions on this draft Rule determination by 10 October 2008.

In accordance with section 101 of the NEL, any interested person or body may request that the Commission hold a hearing in relation to the draft Rule determination. Any request for a pre-determination hearing must be made in writing and must be received by the Commission no later than 5 September 2008.

Submissions and requests for a hearing may be sent electronically to submissions@aemc.gov.au or by mail to:

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¹³ Grid Australia, *Cost Allocation Arrangements for Transmission Services*, 9 July 2008 (Grid Australia supplementary submission).

¹⁴ NGF, *Cost Allocation Arrangements for Transmission Services Rule change: NGF comments on Grid Australia's Alternative Rule Change Proposal*, 18 July 2008 (NGF submission).

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2 Draft Rule determination

2.1 Commission's Draft Rule determination

In accordance with sections 99 and 91A of the NEL, the Commission has determined to propose to make a draft Rule which is a more preferable Rule than the NGF's proposed Rule (Draft Rule).¹⁵

The Commission is satisfied that the more preferable Rule will or is likely to better contribute to the achievement of the National Electricity Objective (NEO) than the NGF's proposed Rule, having regard to the issues raised by the NGF's Rule proposal.

The Draft Rule to be made is attached to, and published with, this draft Rule determination.

2.2 Commission's considerations

This draft Rule determination sets out the Commission's reasons for making the Draft Rule. In making Draft Rule, the Commission has taken into account:

- the Commission's powers under the NEL to make to the Rule;
- the Rule proposal;
- submissions received;
- the Revenue Rule and Revenue Determination;
- the Pricing Rule and Pricing Determination;
- form of regulation factors and revenue and pricing principles under the NEL;¹⁶ and
- the Commission's analysis on the ways in which the proposed Rule will, or is likely to contribute to the NEO so that the statutory Rule making test is satisfied.

For the reasons set out in the following chapters, the Commission has concluded that the Draft Rule satisfies the Rule making test. In brief, having regard to the issues raised, the Commission is satisfied that the Draft Rule will, or is likely to, contribute to the achievement of the NEO better than the NGF's Rule proposal because it

¹⁵ Refer to section 91A of the NEL.

¹⁶ Under sections 88A and 88B of the NEL the Commission is required to take into account the form of regulation factors set out in section 2F and revenue and pricing principles set out in section 7A in certain cases. The form of regulation factors must be taken into account where a proposed Rule either specifies (or confers discretion on the AER to specify through a regulatory determination) a network services as a direct control or negotiated service. The revenue and pricing principles must be taken into account with respect to matters or things specified in items 15-24 and 25 – 26J of Schedule 1 to the NEL.

ensures a greater level of clarity and consistency across the Rules. This includes being more reflective of the underlying objectives and principles of the Revenue Rule.

The NGF has cited several ways in which it considers that its Rule proposal meets the NEO. The Commission acknowledges that the NGF has raised significant issues. However, the Commission has concluded that the NGF's proposed Rule does not address the relevant issues and concerns raised in submission in a comprehensive manner.

In short, the Draft Rule satisfies the Rule making test because it:

- is consistent with the principles of good regulatory design;
- promotes efficiency;
- provides for certainty; and
- provides for consistency.

For example, the Draft Rule:

- clarifies of the meaning, workability and implementation of the grandfathering provisions and cost allocation arrangements in the Rules, enhancing regulatory certainty;
- is consistent with the Commission's objectives regarding the transitioning of connection services from *prescribed transmission services* to *negotiated transmission services* and their removal from the RAB;¹⁷
- clarifies the application of *Cost Allocation Principles* to grandfathered prescribed connection services making them consistent with a shallow connection pricing approach; and
- provides for consistency between existing and new *Transmission Network Users*.

2.3 The Commission's power to make the Rule

The Commission is satisfied that the Draft Rule falls within the subject matters that the Commission may make Rules for as set out in section 34 of the NEL and in Schedule 1 to the NEL. The proposed Rule is within:

- the matters set out in section 34, as it relates to the activities of persons participating in the national electricity market or involved in the operation of the national electricity system; and

¹⁷ This is also consistent with the form of regulation factors.

- the matters set out in items 15-24 of Schedule 1 to the NEL as it relates to the application of provisions in the Rules grandfather assets providing certain connection services as *prescribed transmission services*.

2.4 Differences between the Rule proposal and Draft Rule

The key differences between the proposed Rule and Draft Rule are summarised below.

First, the NGF's proposed Rule seeks to amend clauses 6A.19.2, 6A.19.4, 6A.21.2, S6A.2.3 and 11.6.11 of the Rules as follows:

- Clauses 6A.19 and 6A.21.2 – to clarify that the *Transmission Ring-Fencing Guidelines* do not affect cost allocation as between transmission services (as opposed to cost allocation as between transmission services and other services)
- Clause 6A.19.4 – to draw attention to the requirements of clause 11.6.11 in the context of each TNSP's cost allocation methodology
- Clause S6A.2.3 – to prevent the removal of the value of an asset from the RAB during a regulatory reset in circumstances where:
 - there has been a reconfiguration of the *transmission system*;
 - that reconfiguration causes relevant conditions for removal from the RAB to be met; and
 - the affected transmission network users have not requested or consented to the reconfiguration or have not unreasonably refused or failed to consent to the removal of the asset from the RAB.
- Clause 11.6.11 – to clarify what the NGF understands to have been the intent of this clause:
 - introduces separate definitions of 'eligible assets', 'existing assets' and 'eligible committed assets';
 - provides that services to be grandfathered are those which were being provided when the Revenue Rule came into effect;
 - explicitly grandfathers assets committed to be constructed when the Revenue Rule came into effect;
 - recognises that for so long as the value of a qualifying asset is included in the RAB, a connection service provided by that asset will continue to be treated as a grandfathered service;
 - recognises that, for so long as the price for the service is not negotiated, a connection service provided by a qualifying asset should continue to be treated as a grandfathered service;

- preserves the cost allocation methodology that existed before Chapter 6A came into effect by limiting the costs of assets that may be allocated to prescribed connection services to the costs of those assets which were fully dedicated to the provision of those services at the relevant connection point as at 16 November 2006; and
- deals with any residual portion of the *aggregate annual revenue requirement* (AARR) that may be left unallocated as a result of the point above. First the costs are to be allocated to TUoS and then to prescribed common transmission services.

Secondly, the Commission's Draft Rule seeks to amend clauses 6A.21.2 and 11.6.11 of the Rules as follows:

- Clause 6A.21.2 – to insert an additional provision to the effect that the *Transmission Ring Fencing Guidelines* cannot require allocation of costs as between *prescribed transmission services* and *negotiated transmission services*, or between categories of *prescribed transmission services* in a manner which is inconsistent with the *Cost Allocation Principles*.
- Clause 11.6.11 – to delete the current clause 11.6.11 and insert a new clause 11.6.11 which:
 - creates a suite of definitions for the purposes of clause 11.6.11, being 'existing asset', 'replacement asset', 'eligible asset' and 'prescribed connection services';
 - provides that 'prescribed connection services' are deemed to be *prescribed transmission services*;
 - provides that 'prescribed connection services' will not be treated as *prescribed transmission services* and will be taken to be *negotiated transmission services* when:
 - ... the current term of existing *connection agreements* under which those services are provided expire or otherwise terminate; or
 - ... the *connection agreement* has been amended at the request of the *transmission network user* for the purposes of altering the relevant service;
 - specifies how the general provisions in Chapter 6A apply to prescribed connection services to achieve the same outcome as that proposed by the NGF; (that is, limiting the assets which can be attributed to 'prescribed connection services' and substituting a requirement for allocating any shortfall in costs to another category of prescribed transmission services); and
 - includes certain consequential provisions. For the purposes of clause 11.6.11, when services transfer from *prescribed transmission services* to *negotiated transmission services* then clause 6A.19.2 does not apply and the existing assets or replacement assets will transfer out of the RAB at the next revenue determination.

3 Commission's assessment approach

This chapter set out the Commission's approach for assessing the Rule proposal and alternative options developed through the first round consultation process. Its detailed assessment and the reasons for its draft Rule determination are set out in chapters 4 and 5.

3.1 Methodology

In assessing any proposed Rule change against the NEL criteria the first step is to consider the counterfactual arrangements against which the Rule change is being compared. In the present case the counterfactuals are the current arrangements as well as two other options for resolving the major issue that is the subject of the NGF's Rule proposal, being the grandfathering arrangements in clause 11.6.11. The resolution of this major issue will affect the resolution of the other issues raised by the NGF. To assess the NGF's Rule proposal the Commission's approach has been to:

- clarify the application and operation of clause 11.6.11 in its current form;
- confirm the objectives and principles underlying the Commission's review of the economic regulation of transmission services, as set out in the Revenue Determination;
- examine different approaches to resolving the issues arising from the grandfathering provisions against the objectives and principles; and
- decide on a preferred approach to resolve the grandfathering issues.

On establishing a preferred approach to address the issues arising on grandfathering the Commission has:

- examined the issues regarding cost allocation between the different categories of *prescribed transmission services*;
- examined the issues regarding the removal of assets from the regulatory asset base in the Rules; and
- ascertained the role of the *Transmission Ring-Fencing Guideline* and the relationship to the *Cost Allocation Principles*.

3.2 Rule making test and the National Electricity Objective

In accordance with section 88(1) of the NEL, the Commission may only make a Rule if it is satisfied that the Rule will, or is likely to, contribute to the achievement of the NEO.

The NEO, as set out in section 7 of the NEL, is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.

The NEO is founded on the concepts of economic efficiency (including productive, allocative and dynamic efficiencies), good regulatory practice (which refers to the means by which regulatory arrangements are designed and operated) as well as reliability, safety and security priorities.

According to the NGF the proposed Rule would contribute to the NEO by:

- reducing inefficiency;
- reducing regulatory uncertainty;
- reducing inconsistency in the treatment of generators;
- providing a proportionate response to an issue with the Rules;
- increasing stability and predictability of the regulatory framework; and
- ensuring the robustness of the change.¹⁸

Comments from stakeholders challenge the NGF's claims. Grid Australia has stated that the NGF's proposed Rule does not reduce regulatory uncertainty as it leaves a number of practical difficulties unresolved.¹⁹ The MEU noted that the benefits enunciated by the NGF need to be balanced against equity between new and existing users of the transmission network.²⁰ Similar comments were made by the EUAA. It also stated that the NGF Rule proposal may promote inefficient generation investment and burden consumers with risks that should rightly sit with generators who have the ability to manage and diversify them.²¹

3.3 Form of regulation factors and revenue and pricing principles

This Rule proposal requires the Commission to take into account the form of regulation factors and the revenue and pricing principles. The form of regulation factors refer to the presence of market imperfections in the provision of electricity network services, such as barriers to entry, externalities and market power. The Commission's interpretation of this obligation is that economic regulation of network

¹⁸ Rule proposal, p.17.

¹⁹ Grid Australia, *Cost Allocation Arrangements for Transmission Services*, 2 May 2008, p.10.

²⁰ Major Energy Users, *Cost Allocation Arrangements for Transmission Services*, 16 May 2008, pp.1-2.

²¹ Energy Users Association of Australia, *Cost Allocation Arrangements for Transmission Services*, 2 May 2008, p 4.

services under the Rules should only apply if, and to the extent that, market forces are unlikely to yield competitive provision of those services.

The revenue and pricing principles relate to providing a reasonable opportunity to service providers to recover efficient costs, effective incentives to promote efficiency and to ensuring that prices should allow for a return commensurate with the regulatory and commercial risks involved in providing the service.

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5 Cost allocation arrangements, removal of assets from the RAB and ring-fencing

This chapter addresses issues raised by the NGF relating to cost allocation arrangements for *prescribed transmission services*, removal of assets from the RAB and the *Transmission Ring-Fencing Guidelines*.

The Commission's consideration of the NGF's issues on cost allocation arrangements and the removal of assets from the RAB are predicated on the clarification of the meaning and operation of the grandfathering provisions in clause 11.6.11 of the Rules, as set out in chapter 4.

5.1 Cost allocation arrangements

5.1.1 Issues raised by the NGF

The NGF is concerned about the impact of the *Cost Allocation Principles* in clause 6A.19.2 and the *Pricing Principles for Prescribed Transmission Services (Pricing Principles)* in rule 6A.23. In particular, the NGF is concerned about how these provisions apply to the *connection services* grandfathered under clause 11.6.11 of the Rules in the event of a reconfiguration of assets.

The NGF's preferred interpretation of clause 11.6.11 is that only *entry services* and *exit services* provided by a 'grandfathered' asset as at 16 November 2006 are to be treated as *prescribed entry services* and *prescribed exit services* for the life of the asset. On this basis, the NGF has raised two issues in relation to the cost allocation:

1. existing *connection services* may be subject to inefficient cost reallocation from historically shared assets; and
2. there is a lack of consistency in terms of cost allocation between new and existing connection services.²⁸

These issues are discussed in turn below.

5.1.1.1 Cost reallocation from historically shared assets

The NGF supports the *Cost Allocation Principles* as, in its view, they are aimed at preventing 'inefficient' cost shifting from historically shared assets to dedicated new generator connection assets. The NGF is concerned that costs from historically shared assets can be shifted to generator (connection) assets that existed prior to 9 February 2006 as they form part of the RAB and are therefore grandfathered as *prescribed transmission services*. That is because a *TNSP's* costs are now allocated to each category of *prescribed transmission service* in accordance with the attributable cost

²⁸ Rule proposal p.6.

share over time. Within the categories of *prescribed transmission services*, costs from historically shared assets can be reallocated to *connection services* grandfathered under clause 11.6.11.

According to the NGF, some generators (and network users) face the threat of increases in connection charges due to changes in the shared network beyond their control. In the case of generation, the NGF asserts that other (new) generators are protected from this risk. The two main outcomes from this are:

- Certain generators will face price shocks even though there is no efficiency gain. That is, the generator’s placement decision has been made and hence there is no efficiency gain from imposing increased costs and pricing signals to these “sunk” investments.²⁹
- The market setting will be one of regulatory uncertainty, as there could be a material increase in generator connection charges. This uncertainty could result in investors requiring higher returns. The additional costs resulting from this can increase the barriers to entry and will also have a detrimental impact on productive efficiency. Furthermore, due to the additional uncertainty for generators relating to network reconfiguration – a risk not faced by other market participants - the productive efficiency of the generation sector of the market is more affected.³⁰

5.1.1.2 Lack of consistency between new and existing connection services

According to the NGF, the reallocation of costs described above means that existing generators can face locational pricing signals which they do not have the ability to respond to, and which are the result of a decision made in different regulatory circumstances. The NGF believes that this situation is inequitable and engenders a degree of regulatory uncertainty. The NGF depicts three different situations that in its view can lead to inefficient outcomes according to the current Rules.³¹

5.1.2 Description of NGF’s Rule proposal

To address these issues the NGF proposes a Rule which specifically preserves the cost allocation methodology in respect of grandfathered entry services that applied

²⁹ Rule proposal, p.7.

³⁰ Ibid.

³¹ Rule proposal pp.8–10. The NGF considers that assets that provided TUoS services under the old Chapter 6 could under the new Chapter 6A now be attributed to providing TUoS services and some entry services. In the event of a network reconfiguration (undertaken for the benefit of the shared network), it would be possible for a large set of assets that once provided services to shared network and connection services to be reallocated to providing connection services only. For instance, where load has been shifted from a substation to another substation, a large set of assets could be characterised as providing connection services. And also, where two large network users are charged for connection (exit) services and one of these network users shuts down or leaves, the remaining user would be charged for an extended exit service as a result of this event (which was beyond its control).

immediately prior to the commencement of Chapter 6A of the Rules.³² The proposed Rule limits the costs of assets that may be allocated to *prescribed entry services* or *prescribed exit services* to the costs of the assets which were fully dedicated to the provision of those services at the connection point on 16 November 2006.

According to the NGF, this limitation will maintain:

... the initial cost allocation position under the old Part C and schedule 6.2 of old Chapter 6 in that only fully dedicated assets could be classified as entry assets for which the costs were recoverable through entry service charges. In this way, the proposed Rule will ensure that a generator's attributable cost share can not in future contain costs relating to assets that previously were considered to be providing prescribed TUOS services and hence were shared between Transmission Customers, as a consequence of developments on the network not triggered by the generator.³³

A consequential change is also proposed by the NGF to ensure that the *TNSP* is still able to recover its full *aggregate annual revenue requirement (AARR)* from *Transmission Network Users*. Any portion of the *AARR* that would have been allocated to *entry services* but for the limit described above will remain allocated first to *prescribed TUOS services* (up to the stand-alone amount) and second to *prescribed common transmission services*. Consequently, the *TNSP* will not suffer any revenue shortfall.³⁴

The NGF Rule proposal is seeking to maintain the market position for 'prescribed connection services' prior to the introduction of the Revenue Rule in 2006 while preserving the operation of the new priority ordering approach. This, it says, will improve certainty.

The NGF states that, if implemented, the Rule proposal will ensure that costs:

- allocated to *prescribed entry services* remain consistent and stable over time, thereby avoiding any unforeseen price shocks; and
- remaining after the cost allocation process (as a consequence of the limit on costs which may be allocated to *prescribed entry services*) are allocated to *prescribed TUOS services* and *prescribed common transmission services* to ensure that no revenue shortfall occurs for the *TNSP*.³⁵

³² Rule proposal, p.3.

³³ Rule proposal, pp.3-4.

³⁴ Rule proposal, p.4.

³⁵ The NGF's proposal is made in conjunction with its proposals for clarifying clause 11.6.11 of the Rules. See NGF Rule proposal p.12.

5.1.3 Submissions

Energy Users Association of Australia

The EUAA believes that the NGF's Rule proposal shifts the risk of network reconfiguration affecting existing generators away from those generators and onto electricity users. It does not consider this to be appropriate because the assets may not be contributing to shared network services.³⁶

The EUAA is also concerned that new generators will be at a disadvantage relative to existing generators. The EUAA does not regard this as a regulatory uncertainty issue. It acknowledges that network connection charges change over time and connection versus shared network definitions adapt over time.

Major Energy Users Group

The MEU considers that there has to be equity between the costs incurred by current asset users and the costs a new entrant user will have to pay for the same service.³⁷ It asserts that there has to be equity between users of the same assets. Where entry and/or exit services utilise assets that are used by a number of different users, the cost of providing the service should be shared in proportion to the use each user derives from the service, and between users of the same assets.

The MEU does not believe that aiming to avoid price shocks as suggested by the NGF justifies an inequitable allocation of costs. It does not agree with allowing an existing user of the network to incur a lower cost than it would otherwise simply because certain cost elements of the network service are embedded in another element of the network cost structure should not be permitted.

Grid Australia

In its first submission, Grid Australia explains that another way to resolve the NGF's cost allocation issue is to amend the *Pricing Principles* to provide that costs which have been allocated to 'shared' *categories of prescribed transmission services* must not be reallocated to *prescribed entry services* and *prescribed exit services*. Grid Australia suggests that clause 6A.19.2(7) was originally intended to address the type of issue raised by the NGF but does not do so because the clause does not apply to the allocation of costs between *shared transmission services* and *prescribed entry services* and *prescribed exit services* under Part J of the Rules.³⁸

In its supplementary submission Grid Australia stated that it does not support the NGF's Rule proposal to the extent that it 'grandfathers' a cost position in relation to the costs which may be allocated to deemed *prescribed transmission services* for the

³⁶ EUAA submission, 30 April 2008.

³⁷ MEU submission, 16 May 2008, p.1.

³⁸ Grid Australia submission, 2 May 2008, pp.6-7.

purposes of Chapter 6A so as to preserve the position which previously applied under old Chapter 6 of the Rules.³⁹

It considers that the consequence of 'locking in', under clause 11.6.11, a specific cost allocation for the purpose of Chapter 6A of the Rules would result in a relevant *Transmission Network User* being protected from the ordinary changes in the level of charges for the service which result from changes in the *AARR* of the *TNSP* under its *revenue determination* from time to time.

Rather, in Grid Australia's view, what is required in clause 11.6.11 is a provision which specifies the extent of the *transmission system* assets which are to be regarded as attributable to, or used in, the provision of 'prescribed connection services'.

Grid Australia's approach proposes to ensure that all costs attributable to *prescribed transmission services* are allocated amongst the various sub-categories of *prescribed transmission services*. As a result no amount is unallocated due to the fact that clause 11.6.11 defines 'prescribed connection services' only in terms of 'eligible assets' and limits the assets which may be attributable to the provision of 'prescribed connection services' for the purposes of Chapter 6A to those eligible assets. Any shortfall in costs which would have been attributed under the provisions of Chapter 6A to 'prescribed connection services' (that is, *prescribed entry services* and *prescribed exit services*) will instead be allocated to *prescribed TUOS services*.⁴⁰

NGF response the Grid Australia supplementary submission

The NGF suggested some changes to Grid Australia's approach to cost allocation arrangements. In the NGF's view clause 11.6.11(c)(1) of Grid Australia alternative drafting of the Rule should deal with the costs attributable to eligible assets just as clause 11.6.11(c)(2) deals with the costs attributable to assets that are not eligible assets. In this regard the NGF notes that the National Electricity Rules generally deal with the concept of 'costs' rather than 'assets' being directly attributable to the provision of services.⁴¹

5.1.4 Commission's analysis of the issues

The concerns raised by the NGF can be recast into two key issues:

- cost reallocation within *categories of prescribed transmission services*; and
- effects of *revenue determinations* on grandfathered prescribed connection services.

These are discussed in turn below.

³⁹ Ibid, p.18.

⁴⁰ Grid Australia supplementary submission, 9 July 2008, p.17.

⁴¹ NGF submission, 18 July 2008, p.3.

5.1.4.1 Cost allocation between categories of prescribed connection services

There are three different aspects to the NGF' cost allocation concerns which are the shallow connections approach, reconfigurations and equity considerations.

Shallow connections approach

In the Pricing Determination, the Commission stated that it had substantially maintained the current approach to pricing in the (old) Rules.⁴² A guiding principle adopted by the Commission was that the causer pays principle should be used as a guide to whether, in general, consumers or producers of electricity should contribute towards the recovery of particular costs. The Commission enunciated the view that the majority of transmission investment in the shared meshed network is undertaken to meet the reliability obligations imposed for the requirements of consumers rather than the requirements of generators to evacuate power. That is, most transmission investment is 'caused by' load rather than generation.⁴³ As a result, the principle adopted was that generators are to only pay for shallow connection as it is consumers that cause the need for network assets.⁴⁴

On the basis of this principle, the Commission determined that generators should pay the costs directly resulting from their connection decisions. Accordingly, a 'shallow connection' approach was maintained in the Rules. This approach is consistent with the approach in the old Chapter 6 of the Rules. The Commission explained that the shallow connection approach to pricing for *connection services* was consistent with efficient pricing principles.⁴⁵

Consistent with this approach, the Commission developed a two step approach in the *Cost Allocation Principles*. Firstly, costs are allocated on a directly attributable basis to a particular category of *prescribed transmission service*. Secondly, costs which are not directly attributable are allocated using an appropriate allocator which should, in most cases, be causation based.⁴⁶

Reconfigurations

The Commission considers that the NGF has raised some legitimate concerns about the impact of the new cost allocation arrangements on the services grandfathered under clause 11.6.11. In particular, the NGF has identified that there may be situations where a reconfiguration caused by the needs of the shared network could lead to assets characterised as providing *connection services*. The NGF believes that, in this situation, 'prescribed connection services' may be subject to inefficient cost reallocation from historically shared assets.

⁴² Pricing Determination, p.3.

⁴³ Pricing Determination, p.21.

⁴⁴ Pricing Determination, p.23.

⁴⁵ Pricing Determination, p.20.

⁴⁶ Refer to clause 6A.19.2(3).

In situations where a generator, or large directly connected customer, (that is, a *Transmission Network User*) has not requested or caused a reconfiguration (that is, an “innocent bystander”), the Commission considers that that the value of the reconfigured assets should not be allocated to ‘prescribed connection services’. This is because there is no efficiency gain from reallocating costs from the shared network to the prescribed connection services. The costs of the shared network are sunk.⁴⁷

As implied in the Pricing Determination, the most efficient approach to allocating sunk costs should be to avoid potential distortion in the production and consumption of services.⁴⁸ That is, sunk costs should be allocated to the users whose consumption of the service will not be affected by a change in the price of the same service.

In the event of a reconfiguration of sunk assets, the shared network use (or consumption) of the network will likely be less affected than the use by *Transmission Network Users*. As a result, allocation of reconfiguration costs to the shared network will have the least distortionary impact on the utilisation of the network. Consequently, in the event of an unrequested reconfiguration, there are no economic reasons for the costs of reconfigured assets to be allocated to ‘prescribed connection services’. Instead the costs should remain allocated to *prescribed TUOS services*. The Commission considers this is the most appropriate cost allocation approach to adopt in these circumstances.

Equity

Submissions have suggested that there should be equity between the users of the same assets and that under the NGF proposal existing generators would gain at the expense of electricity consumers.⁴⁹

While sympathetic to these concerns, the Commission considers that it would also be inequitable for those parties receiving ‘prescribed connection services’ to be reallocated costs of the shared network in the event of an unrequested reconfiguration. This is especially true if there was no change in the service being provided by the TNSP. This approach is consistent with the high level causer pays principle. That is, generators and, by implication, directly connected large customers should only pay for shallow connection and not shared network costs.

As noted by the NGF, the *Cost Allocation Principles* applying to *prescribed transmission services* do not preclude the reallocation of costs from *prescribed TUOS services* and *prescribed common transmission services* to *prescribed entry services* and *prescribed exit services*. The NGF claims this is inconsistent with the Commission adopted the

⁴⁷ Pricing Determination, p.2. Sunk costs are referred to as those costs that would not be recovered if the decision that caused those costs to be incurred were reversed.

⁴⁸ The Pricing Determination p. 24 states that “A relevant issue in designing the transmission pricing regulatory framework is therefore how best to recover these historical expenditures while minimising disincentives to the use of existing infrastructure”.

⁴⁹ MEU submission, 16 May 2008; EUAA submission, 7 August 2008.

principle that costs must not be reallocated from *prescribed transmission* to *negotiated transmission services* (that is, *connection services*).

Under Chapter 6A, the intention was for negotiated connection services to be charged with the costs dedicated to providing their *connection service*. Specifically, the *Cost Allocation Principles* preclude the costs of *prescribed transmission services* being reallocated to *negotiated transmission services*⁵⁰. This is consistent with a marginal cost approach to pricing for services and is the basis for the shallow cost approach to pricing for connection services. Therefore, the Commission considers that, by precluding the reallocation of shared network costs to ‘prescribed connection services’, connected parties will be treated on the same basis in relation to sunk costs of the shared network.

Accordingly, on balance, the Commission considers, that, in the event of an asset reconfiguration, the costs attributed to ‘prescribed connection services’ should not be affected. Thereby, *Transmission Network Users* will be treated on the same basis in relation to sunk costs.

Commission’s preferred approach

Under the Commission’s preferred approach to grandfathering, reconfigurations have no adverse impact on cost allocation because the assets attributable to the prescribed *connection services* are limited to the pre-configured connection assets. That is:

- The assets which can be attributed to providing ‘prescribed connection services’ are limited to ‘eligible assets’. That is, ‘existing assets’ or ‘replacement assets’ which were wholly and exclusively used, or committed to be used, to provide the *connection service* at 9 February 2006 or when commissioned or replaced.
- The ‘eligible asset’ category cannot increase as a result of a reconfiguration, caused by the shared network, although it can reduce.
- To the extent that ‘existing assets’, or ‘replacement assets’ are not ‘eligible assets’, their costs are allocated to *prescribed TUOS services* rather than to *prescribed entry services* or *prescribed exit services* or *negotiated transmission services*.

The Commission has concluded that this approach is the most appropriate. It will provide greater certainty to the existing *Transmission Network Users* because it adheres to a shallow connection pricing approach. This approach is also consistent with the arrangements under the old Chapter 6 of the Rules.

⁵⁰ Clause 6A.19.2(7).

5.1.4.2 Impact of revenue determinations on costs for grandfathered connection services

The Commission understands that the NGF's Rule proposal would preclude the application of the pricing arrangements in Chapter 6A to the grandfathered prescribed connection services. One of the consequences of this proposal is to preclude the ordinary changes in the level of charges for the service which result from changes in the *AARR* of the *TNSP* under its revenue determination from applying to the grandfathered prescribed connection services.

As a result, the NGF proposal is not consistent with the Commission's intention in relation pricing arrangements for grandfathered 'prescribed connection services'. The cost allocation arrangements and pricing principles for prescribed transmission services, as set out above, are based on allocating costs of the *AARR*. This demonstrates that the Commission intended that charges for *prescribed transmission services*, including *connection services*, to be subject to the outcome of revenue determinations for *TNSPs*.

In considering the issues raised by the NGF, the Commission concurs with the views expressed in submissions that the NGF's proposal would not be equitable. Users of 'prescribed connection services' should be subject to regulatory changes in charges and prices like other users of the *prescribed transmission services*.

Overall, the Commission considers that the Draft Rule provides greater clarity on the workings of the *Cost Allocation Principles* in the event of a reconfiguration of the assets providing prescribed shared network services. The Commission's consideration has balanced the principles of economic pricing, equity and regulatory certainty. The Commission acknowledges the NGF's concerns about cost allocation in the case of asset reconfigurations but has not, on balance, decided to adopt its proposed approach to address these issues.

5.1.5 National Electricity Objective

The Draft Rule provides:

- for a definition of eligible assets which is limited and, accordingly, addresses the NGF's concerns about the impact of an asset reconfiguration on cost allocation; and
- that, for the purposes of new Chapter 6A the *transmission system* assets that from time to time may be treated as:
 - (i) directly attributable to the provision of a prescribed connection service; or
 - (ii) used in providing a prescribed connection service,

are limited to the eligible assets which under this clause 11.6.11 are attributed, from time to time, to the provision of the prescribed connection service.

The Draft Rule meets the requirements of the NEO as it will:

- Promote efficiency for the pricing of grandfathered *prescribed transmission services*. The Commission's decision in relation to the cost allocation arrangements is consistent with the shallow connection pricing principle and a non-distortionary approach to the allocation of sunk costs.
- Remove uncertainty. The Commission has clarified that in situations where a reconfiguration occurs that was not caused by a directly connected network user, the costs of the assets for those services should not be reallocated to prescribed connection services.
- Promote the efficient use of transmission services and enhance economic efficiency as the use of transmission services by *transmission network users* will not be affected by potential change in charges as a result of a reallocation of prescribed shared network assets to prescribed connection services.
- Provides for consistency in the treatment of existing and new *transmission network users* on the reallocation of sunk costs. The reallocation of sunk costs to 'prescribed connection services' is prevented. This is consistent with the treatment of new generators under the *cost allocation principles*.
- Provide for greater certainty to *transmission network users* in relation to the charges for their *connection services*. These users will not be subject to changes as a result of reconfiguration, undertaken for the benefit of the shared network.

The Commission has had regard to the revenue and pricing principles set out in the NEL. The Draft Rule is consistent with the revenue and pricing principles in that it provides *TNSPs* a reasonable opportunity to recover the efficient costs of providing *prescribed transmission services* ('direct control network services'). The Draft Rule allows for *TNSPs* to recover their efficient costs in the event of a reconfiguration of assets. This will provide appropriate incentives for efficient investment.

5.2 Removal of assets from the regulatory asset base

5.2.1 Issues raised by NGF

The NGF supports the principle in the Rules that prevents the reallocation of costs from *prescribed transmission services* to *negotiated transmission services*. However, the NGF asserts that it is still possible for such a reallocation to occur under the Rules if assets are removed from the RAB by the AER at the time of a regulatory reset, on the basis of a unilateral reconfiguration of the *transmission system* by the TNSP. It considers that this result would be inconsistent with the principles adopted by the Commission in the Revenue Determination. The NGF claims that the issue of reconfiguration of assets is a relatively recent one and is likely to arise more frequently due to the aging nature of much of the network.⁵¹

⁵¹ Rule proposal, p.11.

According to the NGF, if an asset that previously provided shared transmission services becomes a dedicated connection asset, the AER would have the discretion (under clause S6A.2.3) to remove the value of that asset from the RAB (provided all other conditions for removal are also met). Once removed from the RAB, the service provided by that asset could only be characterised as a *negotiated transmission service*. The NGF claims this would leave the network user liable for the full cost of the asset. This creates investment uncertainty for generators.

In addition, the NGF has stated that shifting of costs due to the reconfiguration of assets does not align with the shift of the benefit.⁵² That is, The service provided to the user may not change. Therefore the NGF considers that a network user could be (adversely) affected by a reconfiguration of the *transmission system* without having requested or otherwise given consent to the change.

5.2.2 Description of NGF's Rule proposal

The NGF's Rule proposal aims to ensure that an asset cannot be removed from the RAB as a result of a reconfiguration of the *transmission system* if the relevant *Transmission Network User* or group of users:

- has not requested or consented in writing to the reconfiguration; and
- has not unreasonably refused or failed to consent to the removal of the asset from the RAB within a reasonable time after receiving a written request for such consent from the relevant TNSP. In this situation, such a refusal or failure is deemed not to be unreasonable if that removal, and the consequent application of the TNSP's Negotiated Transmission Service Criteria, is likely to result in an increase in the charges paid by a user of more than five per cent.

Consequently, if an asset which was characterised as providing prescribed TUOS services is reconfigured so that it subsequently provides only entry services, it cannot (as a result of that reconfiguration) be removed from the RAB (and be re-characterised as providing negotiated entry services) unless the above conditions have been satisfied.

5.2.3 Submissions

Grid Australia considered that the NGF's proposed amendment was unnecessary when considered alongside Grid Australia's alternative proposal for the grandfathering provisions. Under Grid Australia's alternative proposal a *transmission system* reconfiguration will not give rise to a situation where assets could be removed from the RAB on the basis that a *prescribed transmission service* under clause 11.6.11 is no longer being provided.

⁵² Ibid, p.11.

Accordingly, Grid Australia considers that the existing provisions in clause S6A.2.3 (on the circumstances in which assets may be removed from the RAB of a TNSP) are adequate if its approach is adopted in clause 11.6.11.⁵³

5.2.4 Commissions' analysis of the issues

As discussed in Chapter 4, the Commission is proposing to amend the grandfathering provisions to a services rather than as assets approach. Under the services approach which has been adopted in the Draft Rule, a reconfiguration of the assets does not change the status of the service from *prescribed transmission service* to *negotiated transmission service*. Therefore the problem raised by NGF could not occur. Accordingly, the Commission does not accept the NGF's Rule proposal on clause S6A.2.3.

In any event, the Commission regards the intention of clause S6A.2.3 is to provide *TNSPs* with an incentive to enter into negotiations with large customers. That is, it would be incumbent on the *TNSP* to enter into commercial negotiations regarding the management of the risk of by-pass or disconnection by large network users. In the event that a *TNSP* does not meet the conditions under S6A.2.3 then the AER is able to remove the value of the assets from the RAB. In this case, the *TNSP* bears the cost of the removal from the RAB. The Commission is satisfied that this arrangement provides the appropriate incentives to *TNSPs* to manage their assets.

5.3 Application of Transmission Ring-Fencing Guidelines to cost allocation

5.3.1 Issues raised by NGF

The NGF has noted that one of the *Cost Allocation Principles* (in clause 6A.19.2(6)) indicates that the method of cost allocation for transmission services should be consistent with *Transmission Ring-Fencing Guidelines* issued by the AER.⁵⁴ The NGF also stated that the drafting of clause 6A.21.2 does not clearly distinguish the functions of those *Guidelines* from the functions of the *Cost Allocation Principles*.⁵⁵ The NGF believes that cost allocation between transmission services should be the exclusive province of the Rules through the *Cost Allocation Principles* rather than being dealt with in the *Transmission Ring-Fencing Guidelines*.

⁵³ Grid Australia supplementary submission, 9 July 2008, p.8.

⁵⁴ Clause 6A.19.2(6) states that the principles, policies and approach used to allocate costs must be consistent with the *transmission Ring Fencing Guidelines*.

⁵⁵ Clause 6A.21.2(b)(1)(iii) provides that the *Transmission Ring-Fencing Guidelines* may include, but are not limited to, provisions defining the need for and extent of "allocation of costs between *prescribed transmission services* and other services provided by the *Transmission Network Service Provider*".

5.3.2 Description of NGF Rule proposal

The NGF's Rule proposal deletes clause 6A.19.2(6) and amends provisions in clause 6A.21.2, in order to remove the ability for the *Transmission Ring-Fencing Guidelines* to deal with the allocation of costs as between transmission services (as opposed to the allocation of costs as between transmission and other services). The NGF seeks to ensure that the allocation of costs as between the different categories of transmission services (including *prescribed transmission services* and *negotiated transmission services*) can only be in accordance with the requirements of the *Cost Allocation Principles*.

5.3.3 Submissions

In its initial submission, Grid Australia agreed with the NGF's observations on this issue and supports the NGF's proposed Rule change.⁵⁶

However, in its supplementary submission, Grid Australia considered that it would be preferable to retain the principle and deal with the issue identified by the NGF through other changes to clause 6A.21.2. It regards the *Cost Allocation Principles* in clause 6A.19.2(6) as a fundamental component of Chapter 6A. Therefore, it would be preferable to amend clause 6A.21.2 to make it clear that the *Transmission Ring-Fencing Guidelines* cannot require allocation of costs between *prescribed transmission services* and *negotiated transmission services*, or between categories of *prescribed transmission services*, in a manner which is inconsistent with the *Cost Allocation Principles*. That is, the AER, in the making the *Transmission Ring-Fencing Guidelines*, should not be able to alter the cost allocation approach which Chapter 6A has established.⁵⁷

5.3.4 Commission's analysis of issues

As stated in the Revenue Determination, the Commission sought to achieve a balance between codifying regulatory decision making processes, methodologies and decision making criteria and providing guided discretion for the AER where appropriate. Certain aspects of the regulatory framework would be inappropriate for inclusion in the Rules. In these areas, the Commission allowed for the Revenue Rule to provide the AER with discretion in the exercise of its regulatory functions.

At the time, the Commission was satisfied that guidelines required by the Revenue Rule relate to the detailed application or implementation of matters that have been provided for at a more general level in the relevant Rule. The Commission's view was that as guidelines constitute a matter of detailed application, it is appropriate that the AER is provided with sufficient direction in the Rules on their formulation, in order to focus the powers conferred on it (that is, the scope of the guidelines).⁵⁸

⁵⁶ Grid Australia submission, 2 May 2008, p.9.

⁵⁷ Grid Australia supplementary submission, 9 July 2008, pp.7-8.

⁵⁸ Revenue Determination, pp.63- 64.

The Commission concurs with Grid Australia's comment that principles stand at a higher level than guidelines.⁵⁹ The intention was for the *Transmission Ring-Fencing Guidelines* to be consistent with the *Cost Allocation Principles*. The Commission agrees with the submissions made that there is scope to improve the clarity in the Rules with regards to the interaction between the *Transmission Ring-Fencing Guidelines* and the *Cost Allocation Principles* and *Cost Allocation Guidelines*.⁶⁰

Under the Rules, the *Transmission Ring-Fencing Guidelines* require, among other things, the accounting and functional separation of *prescribed transmission services* by *TNSPs* from the provision of other services by *TNSPs*. These requirements have a broader scope than the allocation of costs between categories of transmission services which is the subject of the *Cost Allocation Principles*. Therefore, the Commission considers that greater clarification can be achieved by amending clause 6A.21.2 to specify that the *Transmission Ring-Fencing Guidelines* produced by the AER cannot require allocation of costs between transmission services in a manner which is inconsistent with the *Cost Allocation Principles* and *Cost Allocation Guidelines*.

5.3.5 National Electricity Objective

The Draft Rule amends clause 6A.21.2 to provide that the *Transmission Ring-Fencing Guidelines* cannot require allocation of costs as between *prescribed transmission services* and *negotiated transmission services*, or between categories of prescribed transmission services, in a manner which is inconsistent with the *Cost Allocation Principles*.

The Draft Rule meets the requirements of the NEO as it will:

- improve clarity in the Rules about the interaction between the *Cost Allocation Principles* and the *Transmission Ring Fencing Guidelines*; and
- enhance the regulatory design aspects of the Rules by making them more workable and consistent with the Commission's intentions.

⁵⁹ Grid Australia supplementary submission, p.7.

⁶⁰ See Clause 6A.19.3.