



Hydro Tasmania
the renewable energy business

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Dr John Tamblyn,
Chairman, Australian Energy Market Commission,
PO Box H166,
AUSTRALIA SQUARE, NSW 1215

Submission by email: submissions@aemc.gov.au

TRANSMISSION PRICING FOR PRESCRIBED TRANSMISSION SERVICES:
RULE PROPOSAL REPORT

Dear Dr Tamblyn,

Hydro Tasmania would like to thank the AEMC for the opportunity to comment on the Proposed National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 ('**Proposed Rule**') and associated Rule Proposal Report ('**Report**') and for agreeing to give us some additional time to prepare our submission.

Hydro Tasmania is a member of the National Generators' Forum which has provided its own submission in relation to the Proposed Rule and Report. Hydro Tasmania was involved in the preparation of that submission and generally supports the comments contained therein.

However, there are a number of additional specific matters which Hydro Tasmania wishes to raise with the Commission as part of the first round consultation.

As outlined in the attached detailed submission Hydro Tasmania has two principal concerns with the Proposed Rule, namely that:

- (a) the application of the new Part J pricing rules to the calculation of prices for *prescribed entry services* could result in a significant increase in the price payable for *prescribed entry services* when compared to the price which would be payable under the current pricing rules; and

- (b) Rule 6A.33 in its current form may not be sufficient to 'grandfather' the manner in which the prices for *prescribed entry services* are calculated in the future under pre 24 August 2006 *connection agreement* where the *connection agreement* provides for the calculation of charges in accordance with the pricing rules under the NER.

Hydro Tasmania would very much welcome the opportunity to meet with the Commission in order to discuss the matters raised in this submission and our views about possible solutions to the potential outcomes identified in the submission. In that regard, I will contact your office in the near future to arrange a time for a meeting to discuss our submission.

In the meantime, please contact John Arneaud on 0408 589 513 or by email on john.arneaud@hydro.com.au if you have any questions.

Yours sincerely

David Bowker

Manager Regulatory Affairs

DETAILED SUBMISSION

1. Introduction

1.1 Overview

Hydro Tasmania is concerned that the Proposed Rule (and, in particular, the transitional provisions in Rule 6A.33) do not give full effect to what Hydro Tasmania understands to be the intentions of the Commission.

In particularly, Hydro Tasmania is concerned that:

- (a) the application of the new Part J pricing rules to the calculation of prices for *prescribed entry services* could result in a significant increase in the price payable for *prescribed entry services* when compared to the price which would be payable under the current pricing rules; and
- (b) Rule 6A.33 in its current form may not be sufficient to 'grandfather' the manner in which the prices for *prescribed entry services* are calculated in the future under pre 24 August 2006 *connection agreement* where the *connection agreement* provides for the calculation of charges in accordance with the pricing rules applying under the NER.

1.2 Application of Proposed Rule to Hydro Tasmania

These issues are of practical concern to Hydro Tasmania because it is currently being provided with services which will be deemed¹ to be *prescribed entry services* for the purposes of the Proposed Rule. That is (in Hydro's Tasmania's case) *entry services* provided using assets which as at 9 February 2006 were included in Transend's regulatory assets base under Transend's existing revenue determination.

Those services are provided under a *connection agreement* which was first made on 1 July 1998 (i.e. before the commencement of the NEM) and was last amended before Tasmania's entry into the NEM and before the National Electricity Rules ('NER') commenced to apply in Tasmania.

We also believe that the Proposed Rule is likely to have a greater impact on Hydro Tasmania (as compared to other generators) due to the unique nature of Hydro Tasmania's generation portfolio and the manner in which its power stations are connected to the Tasmanian transmission system.²

¹ Under [draft] Rule 11.5.11 of the National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006.

² Unlike other types of generation a power station generating hydro electricity must be located at the fuel source (i.e. at the relevant dam or river). Therefore, any locational signals which may be provided by transmission pricing would have little practical impact on where a hydro power station is located. Secondly, as a result of the first reason, Hydro Tasmania has a greater number of smaller power stations and many of these power stations are connected via radial transmission lines.

2. Intended application of new Part J pricing rules, and principles in the Report

The Report suggests that the Proposed Rule is based on various propositions including:

- (a) 'that existing arrangements may continue to apply' (paragraph 2.11);
- (b) that the Proposed Rule 'works to accommodate existing arrangements' and it is the Commission's 'intention to confirm that under the Proposed Rule, TNSPs can continue to apply existing pricing methodologies but that appropriate modifications consistent with the principles can [may] also be made' (page 48);
- (c) (at page 13) that, in relation to the key transmission pricing issues identified by the Commission, the Commission considers that the current approach to these issues is generally consistent with the NEM Objective and it has not proposed 'substantive changes' in relation to their current treatment in the NER;
- (d) (at page 34) that the Proposed Rule is based on three key propositions. The first is confirming 'the broad acceptability of the approach to pricing in the existing Rules'. The second key proposition involves recasting of the pricing rules to a principles-based form 'while confirming that existing arrangements may continue to apply and [the third key proposition] providing certainty regarding pricing outcomes'.

Hydro Tasmania raises the following issues about the effect of the new pricing rules against the background of these intended outcomes.

3. Issues with Part J pricing rules

3.1 Price shock if new pricing rules apply

Hydro Tasmania considers that the intended outcomes described in the Report are unlikely to result if the new pricing rules in Part J are applied to the calculation of charges for existing *prescribed transmission services* - that is those services grandfathered by [draft] Rule 11.5.11.

If the effect of the Proposed Rule (including the transitional provisions) is that the new pricing rules apply to fixing the charges for deemed *prescribed transmission services* there is likely to be a very significant 'price shock' when the new rules commence.³

The prospect of a price shock arises for two main reasons.

³ Please note that Hydro Tasmania has not had sufficient time to calculate the likely level of any increase. However, initial work confirms that it would be significant depending upon how the new pricing rules were applied.

The first reason relates to the manner in which the new 'causer pays' approach could operate in relation to radial lines which are used to service both generators and shared network requirements. This in practice may result in increased cost allocations for *prescribed entry services*⁴ when compared to the current position.

If a TNSP was required to apply new Part J to the calculation of the prices for *prescribed entry services*, the new pricing rules would require the TNSP to identify those assets which are directly attributable (on a causation basis) to the provision of those services.

That raises the prospect of the cost of assets which, under the current pricing rules in Chapter 6, are treated as part of the shared network (because they are not 'fully dedicated to providing connection to a single Generator or group of Generators' or because they are 'shared to a greater or lesser extent by all users') being regarded as being directly attributable to providing *prescribed entry services* to the relevant generator.

The second reason is the potential effect of the proposed "priority ordering" principles (which are reflected in the cost adjustment rules⁵ and definition of 'stand-alone amount'⁶ in the Proposed Rules).

3.2 Causation test for *attributable cost share*

Under the Proposed Rule that portion of the AARR for *prescribed transmission services* (i.e. the ASRR) is to be allocated to each category of *prescribed transmission services* on the basis of *attributable cost share* for that category of services⁷.

Rule 6A.22.5 deals with the calculation of the *attributable cost share* for a *category of prescribed transmission services*. The calculation of the *attributable cost share* requires identification of the costs of the *transmission system* assets 'directly attributable (on a causation basis)' to the provision of a *category of prescribed transmission services*.

In the case of *prescribed entry services* Rule 6A.22.6 sets out the rules for calculation of the *attributable connection point cost share* in relation to that *category of prescribed transmission services*. Again application of the test involves identification of the costs of the *transmission system* assets 'directly attributable (on a causation basis)' to the provision of *prescribed entry services* at a *transmission network connection point*.

We have identified a number of uncertainties concerning the intended operation of the causation test.

⁴ As defined by Rule 6A.22.2.

⁵ In Rule 6A.24.2(c).

⁶ Defined in Rule 6A.22.2.

⁷ Rule 6A.22.4.

3.3 Uncertainty about intended meaning of the causation test and application of the test

The first uncertainty is the date at which the causation test is to be applied.

At what date is the causation assessment to be made? There logically seem two possibilities under the Proposed Rules. The first would be the first occasion on which Part J has to be applied by a TNSP in respect of an asset. At that time the TNSP would ask what assets are directly attributable to the categories of services then being provided.

The second possibility is that causation is to be judged as at the date the asset first came into existence.

Some elements of the discussion in section 4.1.3 of the Report appear to support the second interpretation. However, the proposed timing of the test remains unclear.

The Report could also be read as suggesting that causation is to be determined on a once and for always basis as at the time that the asset in question is developed. This seems to be the implication from the discussion in the Report at page 53 which says:

'Attribution based on causation implies that attribution does not change if and when use of the asset (or subject of the expenditure) changes.'

This statement suggests that the test require identification of the reason why the asset was constructed in the first place? If so, what happens if the use of the asset has changed over time including where this change occurs before the commencement of the new pricing rules?

In addition, is it really appropriate to apply a causation test to assets which were developed prior to the commencement of the NEM by a vertically integrated electricity body?

This is particularly relevant to Hydro Tasmania where radial lines were constructed by a vertically integrated electricity body (responsible for generation, transmission and supply) initially for the primary purpose only of connecting proposed hydro generation plant and also opening up remote parts of Tasmania for development. Subsequent multiple usage of these radial lines and associated infrastructure has resulted in the TNSP which now has ownership of those assets classifying the transmission lines and associated infrastructure as part of the shared network for the purposes of the Rules.

Hydro Tasmania is concerned that under the new pricing rules either the whole or part of the costs of assets which are currently treated as shared network assets could be treated as costs relating to entry assets (not only because the use of those assets changes in the future but also because the original (but not current) use of those assets was to provide a dedicated service to a generator.

By way of illustration, we note that Transend's current *Transmission Pricing Policy* states, that assets relating to a dedicated radial line that were in existence prior to 1 January 2004 and serve both generators and transmission customers shall be allocated to TUOS service.

Hydro Tasmania would be most concerned if the new pricing rules in Part J (and in particular the causation test) mandated or permitted the costs of assets currently treated as part of the shared transmission network to be allocated to *prescribed entry services* in future.

Hydro Tasmania therefore supports insertion in the Proposed Rule (whether by transitional provision or by other amendment of Part J) of an explicit provision which sets down a rule to the following effect: namely, that assets which as at the commencement of the new pricing rules are treated as part of the shared transmission network, or the cost of those assets, may not be attributed after the commencement of the new pricing rules to the provision of *prescribed transmission services* whether by a change of use of those assets or for any other reason.

3.4 Replacement of asset classification test

One related consequence of the approach taken in the Proposed Rule is that the existing provisions about allocation of categories of transmission system costs in Schedule 6.2 of the Rules have been deleted and have not been replaced by anything definitive principles. Rather, the principles will be developed by the AER.

Hydro Tasmania considers that a number of the principles reflected in Schedule 6.2 for attribution of costs to different categories of services are valuable and should be carried over into the new pricing rules.

3.5 Consequences for Hydro Tasmania of causation test

Regardless of which interpretation of the causation test is intended by the Commission, the result for Hydro Tasmania is likely to be a significant price shock.

If the first approach to causation is taken there is a significant risk for Hydro Tasmania that the TNSP will say that the costs of a range of assets presently regarded by it as providing shared network services are 'directly attributable' on a causation basis to providing entry services on the basis that the usage of those assets is largely to provide entry services to Hydro Tasmania.

If the second approach to causation is taken there is a significant risk for Hydro Tasmania that the TNSP will say that on a causation basis the costs of some assets should be attributed to providing entry services because the reason those assets were first built was to connect new generation plant.

Under either approach entry charges could be expected to significantly increase.

3.6 Proposal for priority of attribution

The second issue for Hydro Tasmania is the effect of the "priority ordering" rules which are to be applied through the cost adjustment rules and the definition of the 'stand-alone amount'. In our view this new rule constitutes a clear departure from the current pricing rules and is likely to result in significant increases in connection charges for generators.

The principles for the allocation of the AARR to categories of *prescribed transmission services* in Rule 6A.24.2 requires the adjustment of the *attributable cost share* where a portion of the AARR would be attributable to more than one category of *prescribed transmission services*.

The adjustment rules require that any costs of a *transmission system* asset or operating and maintenance cost that would otherwise be attributed to the provision of more than one category of services be allocated firstly to the provision of *prescribed entry services* and *prescribed exit services* but only to the extent of the *stand-alone amount* for those categories of services.

Because the AEMC has created a "priority ordering" of services, within the existing cost allocation structure, it has created a scenario where the classification of assets as 'entry services' could lead to the allocation of all the basic costs of the substation to a generator.

This fails to recognise that most generators connect into shared network existing substations. Under the proposed rule, the cost of the shared network substation are first allocated to the generator or customer, even if the shared network substation previously existed.

This highlights the difficulties of applying this concept retrospectively to connections which were established at a time when the development of the overall power system was controlled by vertically integrated utilities.

3.7 Conclusion

Requiring prices for existing *prescribed entry services* to be determined in this way would not deliver any positive influence on pricing or investment behaviour or ensure that '...the transmission prices provide efficient locational and investment signals to participants' (Report at page 12) because one is dealing with sunk costs and already made investment decisions.

Arguably applying the new pricing rules to existing arrangements (given the potential for price shocks) would also detract from promotion of the NEM objective.

Hydro Tasmania submits below that appropriate re-drafting of the transitional provisions can alleviate these issues so far as it is concerned.

.4. Transition to new Part J pricing rules - Transitional and savings provisions

4.1 Introduction

The Commission has sought comment from interested parties about the transitional provisions in draft Rule 6A.33 and 'any other arrangements that may need transitional support'.

In particular, the Commission has stated (see page 64 of the Report):

'Finally, the Commission highlights that where pricing for Prescribed Entry and Exit Services is currently determined under the terms of connection agreements entered into on or before 24 August 2006, these Rules do not apply. This and other transitional issues will be implemented as savings and transitional measures and the Commission seeks comment from interested parties as to any other arrangements that may need transitional support'

Hydro Tasmania understands this to mean that the Commission is seeking views about whether the transitional and savings provisions contained in the Proposed Rule achieve the result which the Report suggests was intended for those provisions, or whether additional transitional arrangements should be put in place.

4.2 Practical effect of draft transitional provision

Draft Rule 6A.33 currently provides:

'Transition to new Part J: Prices for prescribed exit and entry services under existing agreements

If the terms of a *connection agreement* entered into on or before 24 August 2006, provide for the calculation and determination of prices for services that are *prescribed entry services* or *prescribed exit services* by virtue of the operation of [draft] clause 11.5.11, the prices for those services may continue to be calculated or determined under and in accordance with those agreements despite any requirements of Part J of Chapter 6A.'

If draft Rule 6A.33 remains in this form the practical effect would be that the new pricing rules will apply to the fixing of prices for the grandfathered *prescribed entry services* in many cases, instead of the intended effect of preserving the existing charging methodology for grandfathered *prescribed entry services*. This in turn would result in significant increases in the connection charges for some grandfathered *prescribed entry services*.

This outcome seems clearly inconsistent with the intent expressed in the Report that existing arrangements may be continued despite the enactment of new Part J.

It would also be inconsistent with the important consideration noted in the Report (at page 12) that the rules for transmission pricing should promote good regulatory practice by enhancing '...Stability and predictability - that is, transmission prices should be stable and

predictable enough to enable market participants to make long term decisions'.

Set out below are our reasons for this conclusion.

4.3 Why is draft Rule 6A.33 inadequate?

The clause applies to pre 24 August 2006 connection agreements which 'provide for the calculation and determination of prices' for *prescribed entry services*.

Hydro Tasmania understands that most (if not all) connection agreements of this type would contain a provision dealing with how the prices for *prescribed entry or exit services* are to be calculated or determined (i.e. at the very least the connection agreement would contain general provisions which describe how the charges are to be determined).

Hydro Tasmania's concern relates primarily to the second part of the transitional provision where it is stated that '...the prices for those services may continue to be calculated or determined under and in accordance with those agreements despite any requirements of Part J of Chapter 6A'.

A potential difficulty would arise (i.e. the stated intention of the transitional provision would not be achieved with a resulting material impact on the relevant transmission network user) where the connection agreement provides for the calculation of transmission charges in accordance with the pricing rules applying under the NER from time to time.

Hydro Tasmania understands that many connection agreements which were established prior to or shortly after the commencement of the NEM contain provisions requiring the relevant TNSP to fix transmission service charges in accordance with the regulatory arrangements applying to the determination of transmission services pricing from time to time.

This approach tended to be adopted for a number of reasons. For example:

- (a) At the time when these connection agreements were established it was still unclear what form the transmission pricing rules would ultimately take (given that chapter 6 of the then NEC was to be reviewed).
- (b) This type of connection agreement was designed to document an existing connection arrangement between pre-existing assets which were constructed when the relevant parties were a vertically integrated entity and without regard to the eventual division of roles under the NEM.
- (c) The content of this type of *connection agreements* was essentially driven by the TNSP who wanted to make sure that it was not

locked into a charging regime which was inconsistent with the pricing rules.

The practical effect of Rule 6A.33 (when applied to this type of *connection agreement*) would be to required connection charges to be calculated in accordance with new Part J even though the stated intention of the Proposal Report is to grandfather existing pricing arrangements.

4.4 How should the transitional provision be re-drafted?

Hydro Tasmania submits that Rule 6A.33 should adopt a 3 fold approach to the calculation of transmission prices for *prescribed entry* and *exit services* under pre 24 August *connection agreement*.

Firstly, if the *connection agreement* provides for some specific method of pricing (i.e. something more than simply applying the pricing provisions of the NER from time to time) then the parties should be free to agree to continue to apply the agreed contractual method for fixing prices.

Secondly, if the parties to the *connection agreement* wish to move to using the new pricing rules in Part J they should be free to elect to do this.

Thirdly, if neither of the first or second situations apply then the fixing of prices for those services should continue to be able to be carried out under the existing pricing rules in the NER as if they remained in force.

This letter only outlines the basic principles which Hydro Tasmania submits should be reflected in the transitional provisions, rather than to provide a fully developed alternative drafting proposal for the Commission's consideration.

That is because there are a number of complicating issues which seem to have not been yet fully addressed in the Report and Proposed Rule.

4.5 Other issues with the adequacy of the drafting of Rule 6A.33

The following issues relating to the interaction between Rule 6A.33 and the remainder of Part J do not appear to be specifically addressed in the Proposed Rule:

- (a) What does the statement that that prices 'may continue to be calculated or determined under and in accordance with those agreements' mean?

It appears that the current words will only grandfather the existing prices if the *connection agreement* contains a fully self contained process for fixing prices for such services from time to time. That is most unlikely to be the case for most *connection agreements* covering the provision of *prescribed entry* or *exit services*.

At best, this type of *connection agreement* may include an agreed allocation of *connection service* costs (for the purposes of clause

6.4.2 of the NER) with a requirement to fix the prices in accordance with that agreed allocation and the pricing rules applying from time to time.

By that means the parties modify Step 2 under the current pricing rules with the result that the outcome under Step 3 is that the connection charges are different from that which would otherwise result from applying the existing pricing rules in Chapter 6 of the Rules.

Arguably *connection agreements* in this form (providing that prices are to be determined by a modified version of the current pricing rules allocating entry service costs differently than under the current Rules) would not fall within Rule 6A.33 as it is currently drafted unless there was some specific statement in the rule to the effect that prices may continue to be calculated or determined under and in accordance with those *connection agreements* including, where required, by applying current chapter 6 of the Rules as if it still had application.

- (b) It is difficult to understand the practical interaction between Rule 6A.33 and Part J where potentially prices for some *prescribed services* are to be determined under Part J while at the same time prices for other *prescribed services* will be fixed under Rule 6A.33.

Hydro Tasmania understands that Rule 6A.33 contemplates that two parallel processes may take place. On the one hand, *prescribed transmission services* that fall within the scope of Rule 6A.33 will have their prices set by the means described in Rule 6A.33.

Simultaneously, there will be other *prescribed transmission services* to which Rule 6A.33 will **not** apply. The prices for those other services are to be determined in accordance with new Part J.

The services whose price are fixed under Rule 6A.33 will be a sub-set of the *prescribed transmission services* whose prices are otherwise to be fixed under Part J. The revenue earned from the services whose prices are fixed under Rule 6A.33 will form part of the *maximum allowable revenue* of the TNSP.

At what stage is the revenue derived from the services whose prices are fixed under Rule 6A.33 to be taken into account in applying the Part J process? At what stage does it form part of the AARR or is to be taken into account in determining AARR under clause 6A.22.3? How does this fit in with the derivation of the ASRR under clause 6A.22.4? When and how are the costs of the *prescribed transmission services* whose prices are determined under Rule 6A.33 to be taken into account in applying the *attributable cost share* of the remaining *prescribed transmission services* whose prices are fixed under the Part J process?