

I. **Introduction**

The Energy Markets Reform Forum (EMRF), Energy Consumers Coalition of South Australia (ECCSA) and the Energy Users Coalition of Victoria (EUCV) welcome the opportunity to provide views on the Australian Energy Market Commission's (AEMC) Scoping paper on its Review of the Electricity Transmission Revenue and Pricing Rules. The EMRF, ECCSA, and EUCV (collectively referred to as Major Energy Consumers Coalition - MEC) are forums representing the interests and views of major energy end-use industrial customers. The member companies of MEC include the following: OneSteel, BHP Billiton, Bluescope Steel, Tomago, Amcor, Visy Paper, Orica, Holden, Mitsubishi Motors, Adelaide Brighton Cement, Zimifex, Kimberley Clark, Seeley International, Ford, Toyota, Air International and Unidrive. MEC comprise companies whose activities are subject to intense international competition.

The MEC supports the overall objective of the National Electricity Market (NEM), viz.:-

“The national electricity market objective is to promote efficient investment in, and efficient use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system.”

MEC considers the AEMC's transmission revenue and pricing rules review as an important opportunity to facilitate the realization of a National Electricity Market, a journey that was begun with great expectations and that was supported by industrial end users and other stakeholders when it commenced in the early 1990's, but has been burdened by so many false dawns and impediments. The reality concerning the current NEM is that it is a series of regional markets, with relatively weak inter-connections, exposed to inter and intra regional constraints, and conducive to the exercise of market power by participants. In the view of consumers, the challenge of the AEMC's review is to regain the initiative and set the course for the creation of a truly National Electricity Market.

II. **Lessons Learned**

The AEMC Scoping Paper has helpfully pointed to the numerous and extensive reviews of electricity transmission and distribution pricing methodology and approach conducted by the National Electricity Code Administrator over 1997 and 1998 and again in 2000, 2001 and 2002 on similar and related issues. In addition, the ACCC had completed draft and final determinations on the NECA reviews. As well, the MCE had also

commissioned a report by Firecone on the regulatory and institutional framework for transmission in 2003. The most disappointing aspect of the myriad reviews is the absence of any useful and practical outcomes that actually:-

- promotes a fully national market that delivers benefits to consumers;
- provides incentives for efficient network investments; and
- equitably allocates the costs of the networks to beneficiaries of the investments.

One particular aspect of the previous reviews which has caused major angst with consumers is that the reviews have implicitly assumed that there is equality between generators and consumers with regard to access to the transmission network. This assumption leads to the decision that investment in the transmission network (particularly in interconnections) has an equal effect on generators and consumers alike and so any benefit to one is a loss to the other (the “net transfer” of funds remains zero argument). This argument has validity only if both generators and consumers contribute equally to the transmission network – if in fact consumers pay directly for most of the transmission network. Thus if an augmentation of the transmission network is paid for by consumers, then the resulting benefits from the augmentation (in the form of greater generator competition and lower generator prices) must be balanced against the costs consumers incur. Currently the ACCC does not recognize this fact.

Despite all the reviews and debates, the NEM currently exists using the same transmission pricing system provided in the original code albeit with minor modifications, despite the various flaws identified by the ACCC and State regulators.

The key lesson for the AEMC from this brief history of transmission network reviews is to avoid repeating the mistakes of the past. The AEMC has the opportunity to take a fresh approach to the transmission regulation and pricing methodology. A good start is to restate the role of transmission in the MCE report to COAG on 11 December 2003, viz.:

“While transmission accounts for less than 10% of the total cost of delivered electricity, inadequate levels of transmission can result in inefficient energy outcomes. The MCE has adopted the following principles to underpin transmission policy in the NEM:

- *The transmission system fulfils three key roles – it provides a transportation service from generation source to load centre, facilitates competition, and ensures secure and reliable supply.*

- *There is a central and ongoing role for the regulated provision of transmission, with some scope for competitive (market) provision.*
- *Transmission investment decisions should be timely, transparent, predictable and nationally consistent, at the lowest sustainable cost.*
- *The regulatory framework should maximize the economic value of transmission, including through the efficient removal of regional price differences in the operation of the NEM.”*

The key elements in the MCE Statement are, we consider, “facilitation of competition” and “elimination of regional price differentials”. Against this background, MEC considers that the AEMC’s review should seek to:-

- avoid following the overly complicated approaches taken by NECA, et al and adopt a more simplified paradigm;
- avoid a highly prescriptive regulatory ‘crack-down’ approach to new transmission networks, especially inter-connectors;
- accept that transmission network charges are relatively small compared to the final cost of electricity¹ and that better inter-connections maximize consumer benefits in terms of prices, reliability and safety;
- adopt a simple new transmission charging system, and avoid introducing complexities and technical sophistry e.g. with fixed costs representing the bulk of total transmission costs, focus should be on allocating the fixed costs and not chasing down rabbit warrens on short term marginal costs etc.
- adopt a fair and equitable system of beneficiaries pay to facilitate efficient location signals to new generating entrants;
- examine the pro-market overseas best practice systems e.g. the Scandinavian point to point tariff system, the USA regional postage stamp pricing system, and the UK regional boundary framework;
- avoid introducing multiple network providers (e.g. market-based transmission investments) as the business of transmission network should be to encourage free flowing electricity and not to create regional price differentials.

In the view of the MEC members, the above approach to the transmission revenue and pricing review would greatly facilitate and enhance the development of a national electricity market by 2007 (when the AEMC’s two stage process is completed) ten years after the official commencement of the ‘national’ market.

¹ See for example, Bardak’s presentation to the ACCC Public Conference on Transgrid’s Supplementary Capital expenditure proposals, where it was suggested that the cost of all network expenditures proposed for an inter-connected national grid in the 2004 Statement of Opportunities would amount to only \$1/MWh in the electricity price.

III. Specific Comments

1. Transitional Arrangements

The MEC agrees that in principle savings and arrangements may be necessary to facilitate the implementation of new or amended rules. However, the MEC reserves its position on the specific issues that may be involved and on the length of the transitional period.

2. Chapter 5 Issues

The MEC agrees with the issues identified in the Scoping Paper, viz.:-

- The Regulatory Test;
- Reliability Criteria and Technical Standards;
- System Standards;
- Network Performance Requirements; and
- Network Planning and performance

The MEC considers that other issues need to be examined, especially the distortions or impediments to the performance of transmission networks in facilitating free flowing electricity viz. land and easement taxes, the imposition of levies and arrangements for security/protection against terrorism issues.

3. Market Network Service Providers (MNSP's)

The MEC considers that MNSP's tend to embed large regional price differences and operate against the concept of a national electricity market with free flowing electricity. MNSP's capitalise on price differences and benefit from regional constraints. The process for the creation of MNSP's must not be allowed to impede the development of regulated networks and the relevant rules need to explicitly recognize that.

4. Forms of regulation

The MEC supports the adoption of lighter-handed regulatory regimes for transmission networks in view of the costs of transmission relative to the benefits of creating a national electricity market and the free flow of electricity from surplus to deficit regions.

The concept of price monitoring is difficult to support, especially where natural monopolies are concerned. There is simply no scope for transmission networks to be duplicated (except for local by-pass). Transmission networks are strategic, bottleneck infrastructure. Price Monitoring only adds insult to injury where a rapacious monopolist is extracting rents. There is no joy in being well informed that you are over-paying for the services.

5. Asset base and criteria for determining efficient investment

The MEC remains concerned with the requirements in the NEL (s.35(3)(d)) for the Rules to require the AER to have regard to any previous valuations of a transmission system operator's assets, including those made under the National Electricity Code or (especially) jurisdictional legislation. This issue has been a contentious one since the advent of the previous NEC. Inflated and excessive valuations by State Treasuries have operated against the interests of consumers, as well as the spirit and objective of the NEM. All valuations should be left to the market place and not 'grandfathered' by jurisdictions.

There is value in the AEMC investigating new Rules that provide for differential regulated rates of return for different classes of assets in the capital base, and where there are market mechanisms to support robust valuation, these should be valued accordingly, and not using the notional (and very subjective and inflated) replacement cost methodology. In addition provision for differential regulated rates of return to be determined for old versus new assets should be made, as these assets faced different market risks.

The MEC supports the consideration of the issues identified in the AEMC Scoping Paper, including the additional issues suggested above, viz.:-

- the requirement that the AER must 'have regard' to any previous valuation of a transmission system;
- use of market-based valuations where markets exist for assets used in building up the Asset Base.

6. Additional Costs

The review should inquire into the treatment of additional costs such as government levies and other types of quasi taxes (e.g. transmission and greenhouse levies), land and easement taxes and potential security/terror levies.

7. Incentive Mechanisms

The MEC supports the provision of effective incentive mechanisms to achieve cost efficiencies, to make timely and efficient investments and to maintain reliability and service equality. There should also be provision of incentives for global objectives, such as facilitating the development of the inter-state grid and enhancing free flows of electricity. The AEMC's view concerning "trade-offs between cost (and therefore) price and service quality' should also recognize the cost and benefit tradeoffs in achieving strong inter-connections in the national electricity grid.

8. Matters in existing Rules on transmission pricing

The MEC believes that the Rules on transmission pricing should be kept to a minimum and be simple and uncomplicated. Too much complexity and sophistry can hinder the implementation of practical systems that allow participants to "get on with the job".

9. Transmission Pricing Arrangements

The MEC supports the proposed simplification and clarification of the regulatory arrangements by the AEMC. A key objective of the Rules for the regulation of transmission pricing should facilitate the development of the national grid to enhance the free flows of electricity with the NEM.

10. Range of Charges

The MEC considers that generators should be expected to pay access and use of system charges and these should be recovered as part of regulated revenues. This is particularly necessary to create locational equity between generators.

11. Form of shared network use of system charges

State regulators have to date required the CRNP methodology, as currently prescribed in the Rules, reflecting concerns with flaws in the methodology. The MEC considers that it would be futile to seek to review the numerous possible pricing methodologies (as NECA had done) and instead, investigate best practice systems utilized overseas. For example, the Scandinavian point to point tariff system with postage-stamp tariffs based on nodal pricing, should be investigated. This system is reflective of LRMC and locational signals.

The absurdity of assuming that all generation in a region flows to one point and is then re-radiated to all consumers creates bizarre outcomes and unreasonable costs to many consumers, particularly those consumers located adjacent to generators which, are located remotely from the regional node.

12. Guiding discretion

The MEC supports, in principle, a less prescriptive approach, and agrees that guiding discretion should be considered.

13. Procedural requirements for AER decision making

MEC has concerns with some of the processes on transmission regulatory reviews to date. At times they have taken too long to arrive at final determinations; reviews have not been well prepared and frequently lacked transparency in information provision.

Conclusion

The MEC considers that the AEMC has a great opportunity to take a fresh approach to transmission regulation and pricing. There is little value in chasing down numerous rabbit warrens to develop methodology that is overly complex and loaded with technical sophistry. Transmission regulation and pricing should be kept simple. Network charges represent only a small proportion of electricity costs.

The key elements that should guide this review are “facilitation of competition” and “elimination of regional price differences”. The AEMC should also be guided by best practice systems overseas. There is no requirement for originality.

The AEMC should avoid the mistakes of the past, with myriad technical reviews that have contributed marginally to the attainment of a true national electricity market.

The MEC will actively participate in discussion and input into the AEMC reviews and looks forward to assisting in developing transmission network rules that will lead to the goals espoused above.

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