



Australian Energy Market Commission

**Rule Determination**

**National Electricity Amendment (Cost  
allocation arrangements for transmission  
services) Rule 2009**

Rule Proponent  
National Generators Forum

29 January 2009



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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## Abbreviations

AARR	Aggregate Annual Revenue Requirement
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
DNSP	Distribution Network Service Provider
<i>connection agreement</i>	In the case of transmission, an agreement between a TNSP and another person (such as a generator or large customer) by which the person is connected to the TNSP's transmission system and/or receives transmission services
<i>connection service</i>	An entry service (being a service provided to serve a generator or network service provider) or an exit service (being a service to serve a transmission customer or network service provider)
<i>Cost Allocation Principles</i>	For a TSNP – the principles set out in clause 6A.19.2 of the Rules
EUAA	Energy Users Association of Australia
MCE	Ministerial Council on Energy
MEU	Major Energy Users Group
<i>negotiated transmission services</i>	Any of the following services: <ul style="list-style-type: none"><li>(a) a <i>shared transmission service</i> that:<ul style="list-style-type: none"><li>(1) exceeds the <i>network</i> performance requirements (whether as to quality or quantity) (if any) as that <i>shared transmission service</i> is required to meet under any <i>jurisdictional electricity legislation</i>; or</li><li>(2) except to the extent that the <i>network</i> performance requirements which that <i>shared transmission service</i> is required to meet are prescribed under any <i>jurisdictional electricity legislation</i>, exceeds or does not meet the <i>network</i> performance requirements (whether as to quality or quantity) as are set out in schedule 5.1a or 5.1;</li></ul></li><li>(b) <i>connection services</i> that are provided to serve a <i>Transmission Network User</i>, or group of <i>Transmission Network Users</i>, at a single <i>transmission network connection point</i>, other than <i>connection services</i> that are provided by one <i>Network Service Provider</i> to another <i>Network Service Provider</i> to connect their <i>networks</i> where neither of the <i>Network Service Providers</i> is a <i>Market Network Service Provider</i>; or</li><li>(c) <i>use of system services</i> provided to a <i>Transmission Network User</i> and referred to in rule 5.4A(f)(3) in relation to <i>augmentations</i> or <i>extensions</i> required to be undertaken on a <i>transmission network</i> as described in rule 5.4A,</li></ul> but does not include an <i>above-standard system shared transmission service</i> or a <i>market network service</i> .
NEL	National Electricity Law
NEM	National Electricity Market

NEO	National Electricity Objective
NGF	National Generators Forum
Prescribed connection services	For the purposes of this Rule determination, the connection services grandfathered under clause 11.6.11 of the Rules; being <i>prescribed entry services</i> and <i>prescribed exit services</i>
<i>prescribed entry services</i>	<i>Entry services</i> (services provided to a generator at a single <i>connection point</i> ) that are <i>prescribed transmission services</i> by virtue of the operation of clause 11.6.11.
<i>prescribed exit services</i>	<i>Exit services</i> (services provided to a transmission customer at a single <i>connection point</i> ) that are <i>prescribed transmission services</i> by virtue of the operation of clause 11.6.11
<i>prescribed transmission services</i>	Any of the following services: <ul style="list-style-type: none"> <li>(a) a <i>shared transmission service</i> that: <ul style="list-style-type: none"> <li>(1) does not exceed such <i>network</i> performance requirements (whether as to quality or quantity) as that <i>shared transmission service</i> is required to meet under any <i>jurisdictional electricity legislation</i>;</li> <li>(2) except to the extent that the <i>network</i> performance requirements which that <i>shared transmission service</i> is required to meet are prescribed under any <i>jurisdictional electricity legislation</i>, does not exceed such <i>network</i> performance requirements (whether as to quality or quantity) as are set out in schedule 5.1a or 5.1; or</li> <li>(3) is an <i>above-standard system shared transmission service</i>;</li> </ul> </li> <li>(b) services that are required to be provided by a <i>Transmission Network Service Provider</i> under the <i>Rules</i>, or in accordance with <i>jurisdictional electricity legislation</i>, to the extent such services relate to the provision of the services referred to in paragraph (a), including such of those services as are: <ul style="list-style-type: none"> <li>(1) required by <i>NEMMCO</i> to be provided under the <i>Rules</i>; and</li> <li>(2) necessary to ensure the integrity of a <i>transmission network</i>, including through the maintenance of <i>power system security</i> and assisting in the planning of the <i>power system</i>; or</li> </ul> </li> <li>(c) <i>connection services</i> that are provided by a <i>TNSP</i> to another <i>Network Service Provider</i> to connect their <i>networks</i> where neither of the <i>Network Service Providers</i> is a <i>Market Network Service Provider</i>;</li> </ul> but does not include a <i>negotiated transmission service</i> or a <i>market network service</i> .
<i>Prescribed TUOS services</i>	<i>Prescribed transmission services</i> that: <ul style="list-style-type: none"> <li>(a) provide different benefits to <i>Transmission Customers</i> who have a <i>connection point</i> with the relevant <i>transmission network</i> depending on their location within the <i>transmission system</i>; and</li> <li>(b) are not <i>prescribed common transmission services</i>, <i>prescribed entry services</i> or <i>prescribed exit services</i></li> </ul>
RAB	Regulatory Asset Base
Rules	National Electricity Rules

<i>shared transmission service</i>	A service provided to a <i>transmission network user</i> for the use of a transmission system for the conveyance of electricity (including a service that ensures the integrity of the related transmission system)
TNSP	Transmission Network Service Provider
TUOS	Transmission Use of System

## Summary

### Rule change proposal

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.<sup>1</sup>

The NGF's Rule Proposal aims to address an area in the National Electricity Rules (Rules) that the NGF 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.

### Rule determination

In accordance with section 102 of the National Electricity Law (NEL) the Commission has made and published this Rule determination. In accordance with section 103 of the NEL the Commission has made the *National Electricity Amendment (Cost Allocation Arrangements for Transmission ) Rule 2009 No 3* (Rule as Made). The Rule as Made will commence on 13 February 2009.

The Rule as Made is a more preferable Rule than the NGF's proposed Rule.

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 original proposed Rule because it ensures a greater level of clarity and consistency across the Rules. This includes being more reflective of the underlying objectives and principles coming out of the review of the economic regulation of transmission services undertaken by the Commission in 2006.

In short, the Rule as Made satisfies the Rule making test because it:

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

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

The Rule as Made:

- 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;
- is fundamentally sustaining the Commission’s policy intent with regard to the transitioning, over time, of connection services grandfathered under clause 11.6.11 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’.

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

### **Key features of Rule as Made**

The Rule as Made includes the following key features:

- establishes ‘grandfathering’ as *prescribed transmission services* of *connection services* provided by a clearly defined group of assets;
- provides for when ‘grandfathering’ of the *connection services* as *prescribed transmission services* will cease. The triggers include expiry or renegotiation of an existing *connection agreement*;
- clarifies the treatment of costs of the assets used to provide the ‘grandfathered’ *connection services*. In particular, it specifies how the general provisions in Chapter 6A apply to the grandfathered *connection services*; and
- provides for the transitioning of ‘grandfathered’ *connection services* to *negotiated transmission services*. This includes the treatment of costs and removal of assets used to provide the ‘grandfathered’ *connection services* from the regulatory asset base.

# 1 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).<sup>1</sup>

In its Rule Proposal the NGF sought to address what it considered to be 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*.<sup>2</sup> The NGF considered that these ambiguities would result in the costs of other categories of *prescribed transmission services* being allocated to the connection services grandfathered under clause 11.6.11 of the Rules. Under the Rules these grandfathered services are referred to as *prescribed entry services* and *prescribed exit services*. In this Rule determination, these services are referred to collectively as 'prescribed connection services'.

In this Rule determination, terms used in italics have the same meaning as they do in the Rules. The definitions from the Rules for the most commonly used terms in this Rule determination are included in the Abbreviations.

## 1.2 Context

This Rule Proposal has arisen out of certain savings and transitional provisions (clause 11.6.11) included in the *National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006 No. 18 (Revenue Rule)*.<sup>3</sup>

The Revenue Rule was the result of a significant review of the regulation of electricity transmission revenue and pricing undertaken by the Commission under section 35 of the National Electricity Law (NEL). A final Rule determination (Revenue Determination) provided the Commission's reasoning for the Revenue Rule.<sup>4</sup>

In the Revenue Determination, the Commission concluded that the continuation of economic regulation (including a revenue cap approach) for some transmission services was appropriate. At the same time, however, the Commission sought to

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

<sup>2</sup> Clause 11.6.11 of the Rules.

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

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

provide incentives for the negotiated or competitive supply of certain services where appropriate.

Accordingly, the Commission developed the following classifications of transmission services (reflected in the Revenue Rule):

- prescribed transmission services; including use of system services supplied by the shared transmission network which meet the relevant network performance standards; and
- negotiated transmission service; including connection services (entry and exit services) and use of system services supplied by the shared transmission network which exceed the relevant network performance standards.

The Commission determined that prescribed transmission services would be subject to a revenue cap / CPI-X building block approach form of regulation (similar to that which applied under the old chapter 6 of the Rules). Negotiated transmission services, however, would be subject to a lighter form of regulation, being commercial negotiation / arbitration regime. Only revenue from prescribed transmission services was to be subject of the revenue cap. The revenues earned by TNSPs from the provision of negotiated transmission services would be subject to a commercial negotiation regime. It was anticipated that, over time, more assets would be outside the regulatory asset base (RAB). To support this, the Revenue Rule also included provisions for AER oversight of the issue of allocation of costs between prescribed transmission services and negotiated transmission services.

Acknowledging that this classification was a substantial departure from the Rules as they existed at the time, the Commission included in the Revenue Rule a number of savings and transitional provisions to transition to the new Chapter 6A regulatory environment. In particular there was included clause 11.6.11 which was intended to 'grandfather' the treatment of assets which were used by TNSPs to provide services under long term contracts where those assets have traditionally been incorporated into the RAB but would, under the Revenue Rule, be allocated to negotiated transmission services. It is the application of this clause 11.6.11 which is the subject of the Rule Proposal.

The previous Chapter 6 of the Rules also focussed on allocating costs on the basis of assets of TNSPs rather than transmission services. The Commission sought to develop a Rule which would apply economic regulation to transmission services rather than transmission assets.

### **1.3 Problem to be addressed by the Rule Proposal**

Put simply, the primary objective of the Rule Proposal is to prevent the shifting of assets (and consequently costs) to prescribed connection services. The NGF's main concern is the shifting of costs from other categories of *prescribed transmission services* to prescribed connection services. This is an issue because prescribed connection

services are effectively a category of *prescribed transmission services* as a result of the grandfathering under clause 11.6.11.

The NGF believes that the ability to shift assets creates uncertainty. In addition, such a reallocation would cause price shocks to the detriment of generators. It considered 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 were:

- 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.<sup>5</sup> The NGF believes that this is inconsistent with the *Cost Allocation Principles* in Chapter 6A, which prevent the reallocation of costs from *prescribed transmission services* to *negotiated transmission services* (that is, *connection services*).
- Removal of assets from the 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'.<sup>6</sup> Accordingly, this increases the level of investment risk.
- 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*<sup>7</sup>. Similarly Rule 6A.21 does not clearly distinguish between the functions of those Guidelines and the *Cost Allocation Principles*.<sup>8</sup> Accordingly, these anomalies should be addressed.

## 1.4 Rule proponent's proposed solution

In the Rule Proposal the NGF sought to make four substantive changes to the Rules.<sup>9</sup> They are summarised below:

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<sup>5</sup> Rule Proposal, p 6.

<sup>6</sup> Rule Proposal, p 11.

<sup>7</sup> Clause 6A.19.2(6) of the Rules.

<sup>8</sup> Rule Proposal, pp 5-12.

<sup>9</sup> Rule Proposal, pp 3- 4.

- 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 RAB 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.<sup>10</sup> This would address 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.
- 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 on Rule Proposal

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:

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

- Grid Australia;<sup>11</sup>
- Major Energy Users Group (MEU);<sup>12</sup> and
- Energy Users Association of Australia (EUAA).<sup>13</sup>

A further two submissions were received after the closing date from Grid Australia and the NGF.<sup>14</sup>

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

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

In its initial submission, Grid Australia agreed that the existing grandfathering provisions are ambiguous. However, it 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 regarded the NGF's proposal as an overly complex approach to addressing the cost allocation arrangements for grandfathered services. The Grid Australia Supplementary Submission proposed an alternative approach to the NGF Rule Proposal to allow for the transitioning of prescribed connection services to *negotiated transmission services*. Grid Australia suggested that assets replaced on a like-for-like basis continue to be grandfathered. Grid Australia proposed that the expiry of *connection agreements* be used to trigger the end of grandfathering for the relevant prescribed connection service.

In response, to Grid Australia's alternative proposal, the NGF said that it did 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.

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<sup>11</sup> Grid Australia, *Cost Allocation Arrangements for Transmission Services – Response to NGF Rule Change Proposal*, 2 May 2008 (Grid Australia Initial Submission).

<sup>12</sup> Major Energy Users, *Cost Allocation Arrangements for Transmission Services*, 16 May 2008 (MEU submission).

<sup>13</sup> Energy Users Association of Australia, *Request for a Rule Change – Cost Allocation Arrangements for Transmission Services*, 2 May 2008 (EUAA submission).

<sup>14</sup> Grid Australia, *Cost Allocation Arrangements for Transmission Services*, 9 July 2008 (Grid Australia Supplementary Submission). National Generators Forum, *Cost Allocation Arrangements for Transmission Service – Comments on Grid Australia's Alternative Rule Change Proposal*, 18 July 2008 (NGF Submission).

## 1.6 Consultation on draft Rule determination

A draft Rule determination (including a draft Rule) was published on 28 August 2008. The Commission invited submissions on the draft Rule determination by 10 October 2008.

By 5 September 2008, the Commission had not received any requests made under section 101 of the NEL that the Commission hold a hearing in relation to the draft Rule determination.

The Commission received a total of five submissions on the draft Rule determination. They are available on the AEMC website. Submissions were received from:

- AER;<sup>15</sup>
- Grid Australia (two submissions);<sup>16</sup>
- NGF;<sup>17</sup>and
- EnergyAustralia.<sup>18</sup>

Generally, submissions supported the draft Rule determination and draft Rule on the basis that the outcomes would bring greater clarity and certainty in relation to charging arrangements under the Rules.

The major issues arising out of second round submissions were as follows:

- The triggers for grandfathering ceasing. Issues were raised by the NGF and Grid Australia. These issues are considered in chapter 5.
- The need for transitional provisions to deal with consequential matters relating to the transition from current clause 11.6.11 of the Rule to the Rule as Made. This was raised by Grid Australia and is considered in chapter 7.
- Whether *dual function assets* are caught by the Rule as Made. This was raised by EnergyAustralia and is considered in chapter 7.
- Whether the AER requires additional information gathering powers. This was raised by the AER and is considered in chapter 7.

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<sup>15</sup> Australian Energy Regulator, *AEMC's Draft Cost Allocation Arrangements for Transmission Services Rule*, 9 October 2008 (AER Second Round Submission)

<sup>16</sup> Grid Australia, *Cost Allocation Arrangements for Transmission Services 10 October 2008*, (Grid Australia Second Round Submission). Grid Australia, *Cost Allocation Arrangements for Transmission Services – Supplementary Response to Draft Rule Determination*, 12 November 2008, (Grid Australia Second Round Supplementary Submission)

<sup>17</sup> NGF Submission, *Cost Allocation Arrangements for Transmission Services*, 21 October 2008 (NGF Second Round Submission)

<sup>18</sup> EnergyAustralia, *Cost Allocation Arrangements for Transmission Services*, 10 October 2008 (EA Second Round Submission)

A number of drafting issues were also raised during the second round of consultation. They are considered separately in Appendix A.

The Commission published two notices under section 107 of the NEL to extend the time for publication of the Rule determination so as to have adequate time to consider the complex issues raised in submissions during the second round of consultation.

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## 2 Rule determination

### 2.1 Commission's Rule determination

In accordance with section 102 of the NEL the Commission has made and published this Rule determination. In accordance with section 103 of the NEL the Commission has made the *National Electricity Amendment (Cost Allocation Arrangements for Transmission ) Rule 2009 No 3* (Rule as Made).

The Rule as Made is a more preferable Rule than the NGF's proposed Rule.<sup>19</sup>

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 Rule as Made is published with this final Rule determination and will commence on 13 February 2009.

### 2.2 Key features of Rule as Made

The Rule as Made includes the following key features:

- establishes 'grandfathering' as *prescribed transmission services* of *connection services* provided by a clearly defined group of assets;
- provides for when 'grandfathering' of the *connection services* as *prescribed transmission services* will cease. The triggers include expiry or renegotiation of an existing *connection agreement*;
- clarifies the treatment of costs of the assets used to provide the 'grandfathered' *connection services*. In particular, it specifies how the general provisions in Chapter 6A apply to 'grandfathered' *connection services*; and
- provides for the transitioning of 'grandfathered' *connection services* to *negotiated transmission services*. This includes the treatment of costs and removal of assets used to provide the 'grandfathered' *connection services* from the RAB.

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<sup>19</sup> Under section 91A of the NEL the Commission may make a Rule that is different (including materially different) from a market initiated proposed Rule (a *more preferable Rule*) if the Commission is satisfied that, having regard to the issue or issues that were raised by the market initiated proposed Rule (to which the more preferable Rule relates), the more preferable Rule will or is likely to better contribute to the achievement of the national electricity objective.

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## 2.3 Commission's considerations

This Rule determination sets out the Commission's reasons for making the Rule as Made. In coming to its decision in favour of the Rule as Made, the Commission has taken into account:

- the Commission's powers under the NEL to make to the Rule;
- the Rule Proposal;
- submissions received during the first round of consultation and the second round of consultation;
- the Revenue Rule and Revenue Determination;
- the Pricing Rule and Pricing Determination;
- form of regulation factors and revenue and pricing principles under the NEL;<sup>20</sup> and
- the Commission's analysis on the ways in which the Rule as Made 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 Rule as Made satisfies the Rule making test. In brief, having regard to the issues raised, the Commission is satisfied that the Rule as Made will, or is likely to, contribute to the achievement of the NEO better than the NGF's proposed Rule because it 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.

In short, the Rule as Made satisfies the Rule making test because it:

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

For example, the Rule as Made:

- clarifies of the meaning, workability and implementation of the grandfathering provisions and cost allocation arrangements in the Rules, enhancing regulatory certainty;

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<sup>20</sup> 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.

- 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;<sup>21</sup>
- clarifies the application of the *Cost Allocation Principles* to grandfathered *connection services* making them consistent with a shallow connection pricing approach; and
- provides for consistency between existing and new *transmission network users*.

## **2.4 The Commission’s power to make the Rule as Made**

The Commission is satisfied that the Rule as Made falls within the subject matters about which the Commission may make Rules as set out in section 34 of the NEL and in Schedule 1 to the NEL. The Rule as Made 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
- 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*.

## **2.5 Differences between the Rule proposal and Draft Rule, and draft Rule and Rule as Made.**

Appendix B sets out the key differences between the proposed Rule and the draft Rule, and the draft Rule and the Rule as Made.

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<sup>21</sup> This is also consistent with the form of regulation factors.

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### 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 of consultation. The Commission's detailed assessment and the reasons for its Rule determination, including its consideration of comments received during the second round of consultation, are set out in chapters 4- 7.

#### 3.1 Methodology

In assessing any Rule change request 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 has affected the resolution of the other issues raised by the NGF. To assess the Rule Proposal the Commission's approach has been to:

- confirm the objectives and principles underlying the Commission's review of the economic regulation of transmission services, as set out in the Revenue Determination (chapter 4);
- clarify the application and operation of clause 11.6.11 in its current form (chapter 4);
- examine different approaches to resolving the issues arising from the grandfathering provisions against the objectives and principles set out in the Revenue Determination (chapter 5); and
- decide on a preferred approach to resolve the grandfathering issues (chapter 5).

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

- examined the issues regarding cost allocation between the different categories of *prescribed transmission services* (chapter 6);
- examined the issues regarding the removal of assets from the RAB in the Rules (chapter 6); and
- ascertained the role of the *Transmission Ring-Fencing Guideline* and the relationship to the *Cost Allocation Principles* (chapter 6).

The Commission has also considered the comments received during the second round of consultation on the grandfathering, cost allocation and the relationship between the *Transmission Fencing Guideline* and the *Cost Allocation Principles* issues. New issues raised during the second round of consultation are considered in chapter 7. Technical and drafting issues are considered in Appendix A.

### 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, including certainty and consistency) 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.<sup>22</sup>

Comments from stakeholders during the first round of consultation challenged the NGF's claims. Grid Australia stated that the NGF's proposed Rule did not reduce regulatory uncertainty as it left a number of practical difficulties unresolved.<sup>23</sup> 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.<sup>24</sup> Similar comments were made by the EUAA. It also stated that the 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.<sup>25</sup>

The Commission did not consider that the Rule proposed by the NGF would meet the Rule-making test. The Rule Proposal was not consistent with the policy intent of

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<sup>22</sup> Rule Proposal, p 17.

<sup>23</sup> Grid Australia Initial Submission, p 10.

<sup>24</sup> MEU Submission, pp 1-2.

<sup>25</sup> EUAA Submission, p 4.

the Commission in relation to grandfathering of transmission connection services as set out in the Revenue Determination. The Commission issued a draft Rule that was a more preferable Rule that it considered would better meet the Rule-making test in the NEL.

During the second round of consultation, submissions supported the approach taken in the draft Rule determination and the draft Rule subject to the comments considered in the subsequent chapters of this Rule determination. The Rule as Made is also a more preferable Rule.

### 3.3 Form of regulation factors and revenue and pricing principles

In addition to the Rule making test set out in section 88 of the NEL:

- under section 88A of the NEL, the Commission must take into account the form of regulation factors in making a Rule that specifies an electricity network service as a control network service or negotiated network service (as they are defined in the NEL); and
- under section 88B of the NEL, the Commission must take into account the revenue and pricing principles in making a Rule for or with respect to any matter of thing specified in items 15 to 24 and 25 to 26J of Schedule 1 to the NEL.

The subject matter of the Rule Proposal requires the Commission to take into account the form of regulation factors and the revenue and pricing principles.

#### 3.3.1 Form of regulation factors

The form of regulation factors are set out in section 2F of the NEL. They 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 services under the Rules should only apply if, and to the extent that, market forces are unlikely to yield competitive provision of those services.

In its second round submission, the NGF stated that, in its view, the Commission did not adequately take into account the form of regulation factors. The NGF considered that the draft Rule would enable the re-classification of *connection services* from *prescribed transmission services* to *negotiated transmission services*. The NGF expressed the view that any such reclassification requires the Commission to have regard to the form of regulation factors and the Commission has not fully considered the application of these factors in considering the Rule Proposal.<sup>26</sup>

The Rules currently treat *connection services* as *negotiated transmission services*. This classification has not been made as a result of this Rule determination or the Rule as Made.

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<sup>26</sup> NGF Second Round Submission, p 12.

The re-classification of *connection services* as *negotiated transmission services* and their transition to treatment as *negotiated transmission services* were steps undertaken as part of the review of the economic regulation of transmission services. When the Revenue Determination and Revenue Rule were made, the form of regulation factors were not included in the NEL. However, the policy position of the Commission regarding the classification of transmission services for the purposes of economic regulation was, and remains consistent with, the form of regulation factors.

In the Revenue Determination the Commission concluded that, due to their economic characteristics, connection services provided to users of the transmission system were more appropriately regulated under a lighter form of regulation, being the negotiate-arbitrate model. The Commission concluded that the economic characteristics of these connection services were such that consumers for these services are likely to be larger and better resourced, providing a counterweight to the market power possessed by the TNSP and making commercial negotiation a feasible proposition. Following significant consultation on the issue of the classification and economic treatment of transmission services, the Commission established an alternative form of regulation for connection services, being the negotiate-arbitrate model. These conclusions are consistent with the form of regulation factors outlined above.

The Commission remains of the view that a heavy handed approach to economic regulation of the provision of *transmission services* (whether new or existing) is not warranted, as it is possible that market forces can yield competitive provision of those services. In its submission, the NGF did not provide any evidence to support any arguments that the economic characteristics of *connection services* provided to *transmission network users* have changed since the Commission made the Revenue Rule or that the negotiate-arbitrate model is not working.

This Rule determination and the Rule as Made establish an approach to grandfathering that is reflective of and meets the regulatory objectives of the Revenue Determination and the Revenue Rule which are consistent with the form of regulation factors. In making this final Rule determination the Commission has taken into account the form of regulation factors and the Rule as Made is consistent with them.

### **3.3.2 Revenue and pricing principles**

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. The Rule as Made is consistent with these principles. The Rule as Made clarifies the status of connection services affected by clause 11.6.11 and thereby provides for the appropriate allocation of costs and cost recovery. The revenue and pricing principles are directly relevant to the consideration of cost allocation issues in chapter 6.

## **4 Policy context for grandfathering arrangements**

To address the concerns raised about the meaning and application of the existing grandfathering provisions in clause 11.6.11 of the Rules it is necessary to describe the objectives and principles adopted by the Commission in its review of the economic regulation of transmission services as set out in the Revenue Determination.

### **4.1 Objectives and principles**

A fundamental tenet of regulatory economic policy is that direct economic regulation of prices and revenues is an imperfect substitute for effective competition and should be considered only as a last resort, where effective or workable competition is not occurring. This approach was adopted by the Commission in developing Chapter 6A of the Rules. Accordingly, the Commission's approach was to base the form and scope of regulation on the economic characteristics of transmission services and the presence and extent of market power involved in their supply. It concluded that:

- transmission services supplied under monopoly (or near monopoly) conditions such as services provided by the shared network should be subject to forms of economic regulation such as revenue or price cap regulation. Under these conditions these forms of economic regulation can be an appropriate means of providing network operators with incentives for efficient investment; and operation of the infrastructure while also providing incentives to limit the costs and inefficiencies that may arise from the exercise of market power; and
- transmission services supplied under conditions where the service provider has limited market power and there is the potential for commercial negotiation or competitive supply of services should be subject to less intrusive forms of regulation such as a negotiate-arbitrate approach, or not be regulated at all.

The Commission identified the need to provide greater clarity regarding the type of transmission services that should be subject to a more intrusive form of regulation and those that should be subject to a less intrusive form of regulation. Of particular concern to the Commission was the lack of clarity on this matter under the old Rules which it considered had led to an over-inclusion of services under the regulated revenue cap form of regulation. As a result, the transmission use of system charges paid by consumers may have included the cost of services that did not contribute to the services provided by the shared network and would have been subjected to less intrusive forms of regulation. In addition, market outcomes could be distorted by crowding out the opportunities for the competitive supply of services.

#### **4.1.1 Scope of regulation**

In identifying services based on their economic characteristics, the Commission adopted a tiered approach to the regulation of transmission services which sought to

ensure that the form of regulation applied to different classes of service was commensurate with the degree of market power involved in their supply.<sup>27</sup>

The Commission stated that transmission services supplied by the shared transmission network are generally provided under natural monopoly conditions. That is, due to the large capital investment costs, low incremental operating costs and network externalities that are involved, transmission services tend to be supplied more efficiently by a single service provider rather than two or more. However, the absence of competitive pressure from rivals introduces the potential for market failure due to the capacity of a TNSP to exercise its market power. Services provided by these monopoly assets were defined as *prescribed transmission services*.

Some transmission services such as services dedicated to or requested by specific parties, are characterised by either a lack of homogeneity, limited market power, or material countervailing buyer power or the potential for contestable or competitive supply. These services create fewer market failure concerns. In addition, the end users for these services are likely to be large and well resourced. These were defined as *negotiated transmission services*.

Providing a framework in which generators and other large end users can negotiate with TNSPs about the recovery of costs directly related to their connection was seen as an appropriate means to ensure that the costs are subject to scrutiny by a well informed and commercially interested counterparty. This would encourage TNSPs to incur only efficient costs in providing connection services. The scope for the TNSP to exercise market power would be considerably reduced relative to the supply of *prescribed transmission services*. As a result, such services do not require extensive regulation. *Connection services* for transmission fall into this category.

The regime also provides for regulatory oversight of cost allocation between different categories of services. Over time, assets will only be rolled into the RAB when the costs of those services are appropriately allocated to *prescribed transmission services* in accordance with the *Cost Allocation Principles*.

#### **4.1.2 Form of regulation**

As noted above, the Commission concluded that the form of regulation that is appropriate for a particular classes of services should correspond to the degree of market power exhibited in the provision of those services.<sup>28</sup>

For *prescribed transmission services*, the Commission determined that the regulator must use a CPI-X revenue cap form of price control with the maximum allowable revenue determined under the building block approach. This is an intrusive or heavy-handed form of regulation. That is consistent with the substantial degree of market power involved in the supply of shared transmission services.

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<sup>27</sup> Revenue Determination, p 37.

<sup>28</sup> Revenue Regulation, p 40.

For *negotiated transmission services*, where there are fewer market failure concerns, the Commission considered that a commercial negotiation and arbitration regime was more appropriate. Should negotiations between access providers and access seekers fail, an arbitrator could be required to review the basis of the dispute and make a decision on the price and related terms and conditions to be applied.

## 4.2 Transitional arrangements

Under the Revenue Rule, *connection services* are classed as *negotiated transmission services*. However, in order to minimise disruption to arrangements in existence at the time the Revenue Rule was made, the Commission provided transitional arrangements that grandfathered existing *connection services* as *prescribed transmission services*. The provisions in clause 11.6.11 of the Rules allowed for the grandfathering of TNSP assets used to provide *connection services* under long term contracts by TNSPs where those assets had traditionally been incorporated into the RAB.<sup>29</sup>

Without the grandfathering clause, *connection services* provided by assets that existed at the commencement of the Revenue Rule would have been treated as *negotiated transmission services* rather than *prescribed transmission services*.

To avoid this the Commission stated that it would be appropriate for any replacement or reconfiguration of a *connection asset*, grandfathered as providing prescribed services in accordance with clause 11.6.11 of the Rules, to be treated as a *negotiated transmission service asset*.<sup>30</sup>

It is important to note that in establishing this provision, the Commission did not intend that grandfathering be permanent. It was established as a transitional measure only. The reconfiguration and replacement of assets was clearly intended to end the grandfathering of prescribed connection assets.

A key aspect of the Revenue and Pricing Rules was for *negotiated transmission services* (*connection services*) to be subject to a commercial negotiation and arbitration regime. The Commission's objective in relation to the grandfathering provision was for *connection services*, over time, to transition to a negotiate-arbitrate framework. The assets used to provide those services would move out of the RAB.

The Commission did not consider there to be a need for any distinction between *connection services*; that is, between 'new' *connection services* and 'existing' *connection services*. The negotiate-arbitrate framework, including the requirements on TNSPs set out in Part D of Chapter 6A of the Rules, was designed to cater for negotiations in both circumstances.

## 4.3 Meaning and operation of the grandfathering provisions

Clause 11.6.11 provides:

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<sup>29</sup> Revenue Determination, p 126.

<sup>30</sup> Revenue Determination, p.74.

11.6.11 Transition to new Chapter 6A: existing prescribed transmission services

(a) References to prescribed transmission services in the new Chapter 6A include a service provided by an asset used in connection with, or committed to be constructed for use in connection with, a transmission system as at 9 February 2006:

(1) to the extent that the value of the asset is included in the regulatory asset base for that transmission system under an existing revenue determination in force at that time; or

(2) if the price for that service has not been negotiated under a negotiating framework established pursuant to old clause 6.5.9, and, but for this clause, that service would not otherwise be a prescribed transmission service.

(b) Where a service is a prescribed transmission service by virtue of the operation of this clause, that service is taken not to be a negotiated transmission service.

(c) For the purposes of this clause 11.6.11, an asset is, and is only, to be taken to be committed to be constructed if it satisfies the criteria which a project needs to satisfy to be a "committed project" for the purposes of the regulatory test.

The Commission considers that, in its current form, clause 11.6.11 provides for the assets to be grandfathered rather than the particular services provided by the assets at 9 February 2006. On this basis, grandfathering ends on replacement, but not on reconfiguration, of assets.

In the case of asset reconfigurations, the assets are the same and remain in the RAB. Therefore, the status of transmission services does not change from *prescribed transmission services* to *negotiated transmission services*. The Commission acknowledges that this is contrary to the NGF's interpretation. Further, the AER can only remove the value of the assets from the RAB at a reset if a number of criteria are met. These criteria include:

- the asset is no longer contributing to the provision of *prescribed transmission services*. This is not met if the services from those assets are deemed to be providing *prescribed transmission services* (as in the case of reconfigurations); and
- the value of the assets or group of assets exceeds \$10 million (indexed).<sup>31</sup>

The Commission notes that while it is possible to define triggers and timing to end grandfathering, there are three significant impediments to the TNSP recovering costs from the relevant user as charges for *negotiated transmission services* once grandfathering ends. They are:

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<sup>31</sup> Schedule 6A.2.3 of the Rules sets out provisions for the removal of assets from the regulatory asset base. Under S6A.2.3, the Commission intended to provide TNSPs with an incentive to enter into commercial negotiations with large network users to manage any 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 can determine to remove the value of the assets from the RAB.

- operation of existing *connection agreements*: While each contract is different, the Commission understands that there is a substantial risk that TNSPs do not have a contractual right to adjust charges to reflect a change in the nature or cost of the services being provided by an asset under their existing *connection agreements* with users. From discussions with TNSPs, it is understood that *connection agreements* are generally long term arrangements under which *transmission network users* agree to pay TNSPs a specific sum for dedicated connection assets. There may be little scope for new assets being unilaterally allocated to this category by the TNSP.
- *Cost Allocation Principles*: These principles provide that costs allocated to *prescribed transmission services* cannot be reallocated to *negotiated transmission services*.<sup>32</sup> Therefore in the event of a reconfiguration, costs could not be allocated in this way. The Commission acknowledges that this would prevent the outcome intended by the Commission as stated in the Revenue Determination.<sup>33</sup>
- access framework: The ability and practicality of a TNSP initiated negotiation for new services or charges with existing users is limited because the access framework in the Rules is user focussed. The access provisions in Chapter 5 of the Rules do not envisage the TNSP driving the negotiation process. The Commission accepts that it is difficult to see that a *transmission network user* can be compelled, at least as a matter of law, to accept a change proposed by the TNSP.

The Commission has concluded that the approach to grandfathering assets adopted in clause 11.6.11 does not work in the intended manner. As a result, the Commission considered that other approaches to grandfathering should be explored with a view to adopting a workable and practical approach that would meet the regulatory objectives set out in the Revenue Determination. These other approaches are explained in chapter 5.

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<sup>32</sup> Clause 6A.19.2(7) prevents costs which have been allocated to *prescribed transmission services* being reallocated to *negotiated transmission services*. The Commission's policy intent in adopting this approach was to avoid potential for TNSPs 'double-dipping' by recovering certain costs from both *prescribed* and *negotiated transmission services*.

<sup>33</sup> This issue does not arise on replacement as the assets are new and their costs have not strictly been allocated to *prescribed transmission services* in the past.

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## 5 Assessment of grandfathering transmission services

This chapter addresses the issues arising from the NGF's proposed changes to the grandfathering provisions in clause 11.6.11 of the Rules. The discussion includes the consideration of matters raised in submissions in response to the Rule Proposal as well as the draft Rule determination and draft Rule, and an assessment of alternative solutions to the NGF's concerns, bearing in mind the principles and objectives articulated in chapter 4.

Comments raised during the second round of consultation are considered in sections 5.5 and 5.6 below. Comments relating to drafting and clarification issues on grandfathering are considered in Appendix A.

### 5.1 Issue raised by the NGF in Rule Proposal

The NGF has sought to clarify what it considers to be ambiguities relating to grandfathering provisions in Chapter 11 of the Rules. In its view, the current Rules can lead to the inefficient shifting of costs from *shared transmission services* to prescribed connection services as a result of a reallocation of costs or a network reconfiguration undertaken for the benefit of *transmission network users* generally. This creates a possibility for generators to experience price shocks.

The NGF considers it essential that *connection services* be classified on a clear and unambiguous basis either as *prescribed transmission services* or *negotiated transmission services*, as this will determine the principles that apply for the purposes of allocating costs to that service.

### 5.2 Description of NGF's Rule Proposal

The NGF's objective is to prevent the reallocation of costs of assets used to provide historically shared *prescribed transmission services* to existing prescribed connection services. Under the NGF's preferred interpretation of clause 11.6.11 of the Rules, services provided by the assets at a 'particular point in time' would be grandfathered. Therefore, in a situation where there is a reconfiguration of the assets, undertaken for the benefit of the shared network, and a different service would be provided, that new service is not grandfathered. The new service would be classified as a *negotiated transmission service*.

In the Rule Proposal, the NGF stated that its proposed Rule would ensure that only those assets which provided *entry services* before the Revenue Rule came into operation (16 November 2006) would be grandfathered. It considered this to be consistent with the intent of this provision and the underlying purpose of grandfathering, which was to ensure that matters treated in a particular way before a regulatory change continue to be treated in the same way after that change.<sup>34</sup>

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<sup>34</sup> Rule Proposal, p.3.

The NGF stated that:

‘...the proposed Rule clarifies that it is the services provided by relevant assets at a point-in-time that are grandfathered, and not the services provided by those assets at any time. A subsequent change in the use of an asset (e.g. from network to dedicated connection as a consequence of a reconfiguration project undertaken to benefit network users) cannot result in new prescribed entry services being provided by that asset. Such services will instead be classified as *negotiated transmission services*.’<sup>35</sup>

## 5.3 Submissions from first round of consultation

### 5.3.1 Grid Australia

In its initial submission, Grid Australia expressed support for measures that increase regulatory certainty and reduce the scope for ‘uneconomic’ price shocks. However, it expressed concern that the Rule Proposal did not sufficiently address the shortcomings of the current grandfathering provisions. In particular, Grid Australia considered that further amendments to clause 11.6.11 were required to ensure that the grandfathering arrangements could operate in a practical and effective way.

Grid Australia identified a number of concerns relating to clause 11.6.11 that would not be addressed by the Rule Proposal, including:

- Confusion as to whether services or assets (or both) are grandfathered. The current clause is drafted as if it is grandfathering services, although the AEMC’s comments at the time of making the Rule could be read as suggesting an intention to grandfather assets.
- There is no clear trigger as to when a prescribed connection service ceases to be grandfathered. Nor is it clear what precise changes in the assets used to provide a grandfathered connection service trigger a change in status of the service or part of the service.
- The application of clause 11.6.11 to the replacement of assets that were previously used to provide prescribed connection services is open to interpretation. Grid Australia advised that the AER has concluded that it is currently obliged to interpret clause 11.6.11 as requiring any replacement of a grandfathered asset to be treated as providing a *negotiated transmission service* and therefore to be remunerated outside the TNSP’s revenue cap. According to Grid Australia, the practical implications of the AER’s interpretation include:
  - Network users would be required to engage in negotiation with TNSPs for *entry services* and *exit services*, as assets technically transition from *prescribed transmission services* to *negotiated transmission services*. These negotiations

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<sup>35</sup> Rule Proposal, p 3.

would be required even if neither party wishes to change the existing service or the charges for the existing service.

- The existing Rules relating to a TNSP's negotiating framework are predicated on the presumption that the *transmission network user* is seeking a service from the TNSP. However, if negotiation is required as a result of an asset replacement, it is the TNSP that will be approaching the network user in order to provide 'new' *negotiated transmission services*. The TNSPs' existing negotiating frameworks do not contemplate this situation.
- Network users and TNSPs may be required to engage in multiple renegotiations in respect of the same *entry service* or *exit service* as connection assets are replaced over time.

Grid Australia requested that the AEMC examine clause 11.6.11 more broadly in light of the Rule Proposal and its own submission. In any event, Grid Australia considered that the proposal put by the NGF was not the only, or the preferred, means of dealing with the issues identified by the NGF.

The Grid Australia Supplementary Submission proposed an alternative to the Rule Proposal. It aimed to address broader issues not covered by the Rule Proposal. Grid Australia outlined a number of clear principles which it submitted should underpin any redrafting of clause 11.6.11; the most important being:

- *negotiated transmission services* can only arise through a process of negotiation and cannot be deemed to exist between a TNSP and *transmission network user* under the Rules; and
- *connection services* can be provided at a *connection point* on a 'divisible' basis, and hence multiple or separate services could be provided.<sup>36</sup>

Grid Australia's proposal was to replace clause 11.6.11 in its entirety with a clause of a simpler structure to that proposed by the NGF. In general terms, the new clause 11.6.11 proposed by Grid Australia would 'grandfather' as *prescribed transmission services*, *connection services* (called 'prescribed connection services') provided by a defined group of transmission system assets (called 'eligible assets'). The new clause would also deal with how the general provisions in Chapter 6A apply to prescribed connection services. The grandfathering of services as *prescribed transmission services* would cease on expiry or termination of an existing *connection agreement*.

### 5.3.2 NGF response to Grid Australia

In response to the Grid Australia alternative, the NGF commented that:

- it did not agree that a *connection service* provided by an existing or committed eligible asset should cease to be treated as a *prescribed transmission service* on the

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<sup>36</sup> Grid Australia supplementary submission, 9 July 2008, pp.6-7.

basis that the service is provided under a *connection agreement* that is entered into after the commencement date;

- *connection agreements* are a contractual matter between parties, and hence are expected to differ widely as to their terms, coverage, history and duration;
- that clause 11.6.11 of the Rules is intended, in the NGF view, to grandfather connection services provided by such assets for the life of those assets, irrespective of the term of any *connection agreement* pursuant to which the TNSP provides *connection services* to the relevant *transmission network user*; and
- the alternative Rule drafting put forward by Grid Australia would result in existing *connection services* prematurely ceasing to be grandfathered, and would leave affected connected parties (recipients of *entry services* or *exit services*) exposed to unjustified price increases. On this basis, the use of *connection agreements* as a grandfathering termination trigger would be inappropriate and inconsistent with the NGF's original objectives of avoiding price shocks and promoting regulatory certainty.

#### **5.4 Commission's analysis of the issues from first round of consultation**

The Commission carefully considered the matters raised in the Rule Proposal and in submissions received during the first round of consultation. The Commission recognised the need for clarity on the meaning of the grandfathering provisions to ensure their application and workability in a manner consistent with the regulatory objectives in the Revenue Rule.

This section comments on the key issues relevant to the Rule Proposal and assesses the possible solutions to the grandfathering provisions of clause 11.6.11.

The Commission has concluded that the approach to grandfathering assets adopted in clause 11.6.11 does not work in the intended manner, as described in chapter 4 above. As a result, the Commission has considered that other approaches to grandfathering should be explored with a view to adopting a workable and practical approach that would meet the regulatory objectives set out in the Revenue Determination, as explained in chapter 4 above.

##### **5.4.1 Criteria for evaluating the options for grandfathering**

On the basis of the principles described in chapter 4 above, and the fact that clause 11.6.11, in its current form, poses consequential issues, a consideration of possible options / approaches for improving the operation of the grandfathering provisions was undertaken.

In order to assess alternative options for grandfathering provisions the Commission has developed a set of criteria. These criteria relate to the Commission's intentions in regulating transmission services, as summarised above in chapter 4, while recognising commercial arrangements between TNSPs and *transmission network users* and the need for certainty and clarity. The assessment criteria adopted were:

- provides a clear and practical trigger to end the grandfathering provisions to facilitate transitioning of 'prescribed connection services' to *negotiated transmission services*; and
- allows for fair and reasonable transitioning with respect to the existing commercial and legal arrangements between TNSPs and *transmission network users*.

These criteria were used to assess the Rule Proposal and other identified options to clarify the interpretation and operation of the grandfathering provisions in clause 11.6.11.

#### 5.4.2 Assessment of grandfathering options

The Commission identified three options based on grandfathering connection services (rather than assets used to provide those services, as is currently the case) as *prescribed transmission services* to address the issues raised.

The description of each option included what was being grandfathered and what, if anything, would trigger the end of grandfathering. Each discussion also included a consideration of the impact of asset reconfigurations and replacement.

Each option was assessed against the criteria identified above.

##### 5.4.2.1 Option 1: NGF services approach

The key features of the NGF services option were:

- Grandfathers, as *prescribed transmission services*, the services provided at 16 November 2006 by existing and committed assets as at 9 February 2006 (2006 Assets).
- Provides that reconfiguration might lead to assets providing *negotiated transmission services* and therefore an end to grandfathering.
- The costs of the new services could not be allocated to *negotiated transmission services* because of the *Cost Allocation Principle*. In this case the services would continue, in effect, to be treated as *prescribed transmission services* as the price to be paid is not negotiated.

##### Comment

The NGF services option was not consistent with the policy intent of the Commission because it did not:

- provide for a transition of services to *negotiated transmission services* and, therefore, a removal assets from the RAB. The NGF's approach was aimed at maintaining the grandfathering of prescribed connection services indefinitely. Under this option any new services arising from a reconfiguration would be *negotiated transmission services* – although the costs of these services would be

reallocated to the *shared transmission services (prescribed transmission services)*. This outcome would be inconsistent with the regulatory framework adopted in Chapter 6A.

- acknowledge the existence of *connection agreements* and therefore did not provide an approach for dealing with them.
- provide a clear trigger for the end of grandfathering. Under this approach a replacement of assets would end grandfathering. However, this issue was not considered by the NGF and so uncertainty remained as the consequences were not explained.

#### 5.4.2.2 Option 2: Grid Australia services approach

The key features of the Grid Australia option were:

- Grandfathers connection services, called ‘prescribed connection services’, provided by a defined group of transmission system assets called ‘eligible assets’.
- A ‘prescribed connection service’ had to be provided under a *connection agreement* which was first entered into before the commencement date (prior to the new Chapter 6A).
- Prescribed connection services were to be regarded as ‘divisible’ services. Where an improvement or increase in service occurred at the request of the *transmission network user* the required higher capability would be outside the concept of replacement. The service required to provide the additional or higher capability was to be regarded as a request for a *negotiated transmission service*. The higher capability would be treated as a ‘divisible connection service’.
- Using the divisible services concept, it would be possible to have a grandfathered *connection service* (a ‘prescribed connection service’) and another non-grandfathered (a ‘negotiated connection service’ or a ‘non-regulated transmission service’) being provided at the same connection point.
- An existing service would remain a ‘prescribed connection service’ even if some or all of the eligible assets used to provide the ‘prescribed connection service’ were replaced on a like for like basis.
- Reconfiguration of assets would not end grandfathering but the proposal limited the assets which could be attributed to ‘prescribed connection services’ by allocating any shortfall in costs to another category of prescribed transmission services.
- The expiry of a *connection agreement* would trigger the end of grandfathering of a *connection service*.

#### Comment

This option met the criteria to a greater extent than the NGF option (option 1) because it:

- provided for a transition of services to *negotiated transmission services* and therefore, a removal of assets out of the RAB. It was consistent with the intention that grandfathering was to be a transitional measure. The divisibility of services approach would result in transitioning over a longer period of time than option 3 below.
- acknowledged the existence of *connection agreements* and provided for the creation of *negotiated transmission services* in a context where there is a true negotiation between the parties.
- provided a clear trigger for the end of grandfathering, being the expiry or termination of an existing *connection agreement* providing ‘prescribed connection services’. Following expiry or termination, any further connection services would be negotiated and occur either as *negotiated transmission services* or as *non-regulated transmission services*.

This option differed from the position under existing clause 11.6.11 (as it has reportedly been interpreted by the AER) because it would allow an existing grandfathered *connection service* to remain as a ‘prescribed connection service’ even if some or all of the existing assets (or committed assets) are later replaced on a like-for-like basis.

However, if a *transmission network user* requested a service additional to the existing service then the divisibility provision would apply. The existing service would remain as a prescribed connection service (ie *prescribed transmission service*) but the additional service would be a *negotiated transmission service*.

The use of the divisibility of services concept could cloud the distinction between *prescribed transmission services* and *negotiated transmission services* which are effectively the same service. While possible in theory, it is questionable whether this approach would be consistent with the definition of *negotiated transmission services* which includes *shared transmission services* which exceed regulatory requirements. The definition suggests that *negotiated transmission services* constitute one service while the concept of divisibility contemplates that part of the service meeting the standard is a *prescribed transmission service* while the excess is a *negotiated transmission service*. The conceptual complexity of option 2 could lead to variations in its interpretation, causing unintended consequences in its implementation.

The Commission noted that the NGF does not support the use of *connection agreements* to end grandfathering provisions. The NGF argued that the use of *connection agreements* was an arbitrary approach. In the Commission’s view the NGF’s objections were based on its assumption, and preferred view, that grandfathering of prescribed connection services should continue indefinitely.

#### **5.4.2.3 Option 3: Alternative services option**

Option 3 was based on the Grid Australia option. It amended option 2 with the aim of reducing its complexity. The key features of option 3 were:

- Creates a category of ‘prescribed connection services’ being, the services provided:
  - under a *connection agreement*; and
  - by defined *transmission system* assets (‘eligible assets’).
- Grandfathers as *prescribed transmission services* the category of ‘prescribed connection services’.
- A ‘prescribed connection service’ must be provided under a *connection agreement* which was first entered into before the commencement date (prior to the new Chapter 6A).
- An existing service would remain as a ‘prescribed connection service’ even if some or all of the ‘eligible assets’, used to provide the ‘prescribed connection services’, are replaced on a like for like basis. Reconfiguration of assets would not end the grandfathering of the service while an existing *connection agreement* is in force and the reconfiguration is not as a result of a request by the customer.
- The expiry of the *connection agreement* would trigger the end of grandfathering of the *connection service*. Extensions of such an agreement on the same terms and conditions beyond the existing term would not be considered an expiry of an agreement. In such cases the grandfathering would continue.
- A customer initiated change to a *connection service* requiring negotiation of new or additional services under an existing *connection agreement* would also constitute an end to grandfathering of the total service (this is a variant from option 2). The amended service would be treated as request for a *negotiated transmission service*.

#### Comment

Of the three options presented, option 3 was the most consistent with the criteria established above. This is because it:

- provided for a transition of services to *negotiated transmission services* and therefore, a removal of assets out of the RAB, acknowledging the intention that grandfathering was to be a transitional measure. The transition would occur over a shorter period of time than option 2, as grandfathering of the total service would end when the *transmission network user* sought an amended service.
- acknowledged the existence of *connection agreements*. It provided for the creation of *negotiated transmission services* in a context where there is a true negotiation between the parties.
- provided a clear trigger for the end of grandfathering, being the expiry or termination of an existing *connection agreement* providing ‘prescribed connection services’.

The Commission considered that this approach was simpler than the Grid Australia option (option 2) because the concept of divisibility of connection was not required.

Incidental changes to the Rules would be required to implement this approach; including permitting the removal of assets from the RAB and some relaxation of the *Cost Allocation Principles* to enable reallocation of costs from *prescribed transmission services* to *negotiated transmission services*. The Commission did not consider these incidental changes to be problematic.

## 5.5 Submissions from second round of consultation

While generally supportive of option 3, Grid Australia and the NGF raised issues in relation to the Commission's preferred approach to grandfathering. The effect of the comments from these stakeholders would be to amend option 3.

### 5.5.1 NGF Second Round Submission

#### 5.5.1.1 Expiry of a connection agreement as a trigger to end grandfathering

The NGF did not agree that the expiry of a *connection agreement* should automatically result in the connection service that was being provided under that agreement ceasing to be grandfathered (and therefore be reclassified as a *negotiated transmission service*).<sup>37</sup>

The NGF considered that the form of regulation factors should be applied on a case by case basis to determine whether grandfathering should cease on the expiry of a *connection agreement*. The NGF proposed that once a *connection agreement* expired, the TNSP should nominate the service for assessment at the commencement of any subsequent *regulatory control period*, with that service being assessed by the AER as to whether the grandfathering should cease against the form of regulation factors.<sup>38</sup> The NGF indicated that the AER has a similar role in the context of *Distribution Network Service Providers* (DNSPs).

The NGF stated that the form of regulation factors have a role to play because they provide a framework for assessing whether *transmission network users* have appropriate countervailing market power to negotiate the price or quality of service provided by a monopoly TNSP.<sup>39</sup> In the NGF's view, generators seeking to renegotiate existing *connection services* are at a relative disadvantage in negotiating with TNSPs compared with generators seeking new *connection services*. The NGF argued that, unlike proposed recipients of new *connection services*, recipients of existing *connection services* do not have countervailing market power to negotiate the price or quality of service provided by a TNSP.<sup>40</sup>

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<sup>37</sup> NGF Second Round Submission, p 3

<sup>38</sup> NGF Second Round Submission, p 18

<sup>39</sup> NGF Second Round Submission, p13.

<sup>40</sup> NGF Second Round Submission, p.11, 17.

### 5.5.1.2 Divisible/Incremental services approach

The NGF submitted that an existing connection service should remain a *prescribed transmission service*, notwithstanding any incremental or additional service requested by the connected party under its connection agreement. While such incremental or additional connection services would be treated as *negotiated transmission services*, it would be only if a request is made to change the existing *connection service* itself that grandfathering of the that connection service should cease. The NGF considered that the draft Rule should be amended to give effect to this principle.<sup>41</sup>

### 5.5.1.3 Transition to negotiated transmission services

The NGF stated that there is an inherent difficulty where a *connection agreement* is renegotiated or entered into during a *regulatory control period*. In such a case the value of the assets providing the *connection service* may only be removed from the RAB at the next regulatory reset, with a consequent reallocation of costs. However, it is unclear how these services should be charged for during the period between the new or amended *connection agreement* coming into effect and the commencement of the next *regulatory control period*. In this regard, in the NGF's view, there seems to be a risk of double counting as a result of the asset continuing to be included in the RAB while the service is also being charged as a *negotiated transmission service*.<sup>42</sup> The NGF has requested that the Commission clarify its intentions in this regard. Grid Australia also raised a similar issue in its Second Round Submission.<sup>43</sup>

## 5.5.2 Grid Australia Second Round Submission

### 5.5.2.1 Use of eligible assets to provide new connection service

Grid Australia suggested that there may be situations where a *transmission network user* requests an alteration of a 'prescribed connection service' and this altered connection service could be provided by the TNSP using only 'eligible assets'. In these situations, Grid Australia stated that the grandfathering not should cease in relation to the relevant service.<sup>44</sup>

### 5.5.2.2 Short term divisibility of services

Grid Australia requested that the Commission clarify the need to accommodate a short term, finite and temporary divisibility of connection services to manage a customer request for a change to a prescribed *connection service* within a *regulatory control period*. It proposed that a divisible *connection service* would be provided only

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<sup>41</sup> NGF Second Round Submission, p 18.

<sup>42</sup> NGF Second Round Submission, p 18

<sup>43</sup> Grid Australia Second Round Submission, p 11

<sup>44</sup> Grid Australia Second Round Submission, p 7.

during the balance of the relevant regulatory control period. In Grid Australia's view this would:

- give the TNSP the right to render charges for the service provided;
- enable the TNSP to provide a negotiated transmission service during the existing regulatory control period; and
- avoid 'double dipping' for an additional interim *negotiated transmission service*.<sup>45</sup>

However, Grid Australia acknowledged that amendments to the Rule were not strictly necessary in order to achieve these objectives.<sup>46</sup>

## **5.6 Commission's analysis of grandfathering issues arising out of second round of consultation**

The Commission has considered the submissions on its proposed approach to grandfathering received during the second round of consultation. Below is the Commission's analysis of the major grandfathering issues raised being:

- distinction between new and existing *connection services*;
- proposed role of the TNSP and AER to determine if grandfathering should cease on expiry of a *connection agreement*;
- short term divisibility of services and transition to *negotiated transmission services*; and
- whether use of eligible assets to provide a new requested service should cease grandfathering.

### **5.6.1 Distinction between existing connection services and new connection services**

In the Revenue Determination the Commission concluded that, due to their economic characteristics, connection services generally were more appropriately regulated under a lighter form of regulation, being the negotiate-arbitrate model. The NGF did not provide adequate evidence that the economic characteristics of *transmission network users* of existing *connection services* were different to those of users of new *connection services*. Further, the NGF did not provide evidence that the negotiate-arbitrate form of regulation was inappropriate in the circumstances.

The NGF suggested some differences between the bargaining / market power positions of existing and new *transmission network users*.<sup>47</sup> The Commission considers

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<sup>45</sup> Grid Australia Second Round Submission, pp 10-11.

<sup>46</sup> Grid Australia Second Round Submission, pp 11-12.

<sup>47</sup> NGF Second Round Submission, pp 9 – 10.

that, to a certain extent, TNSPs may be in a limited bargaining position as well as *transmission network users* in the case of existing *connection services*. TNSPs own these assets which are largely user specific and it is in their interests to obtain a return on them.

The negotiate – arbitrate model is set out in Part D of Chapter 6A and it accommodates the risks and issues raised by the NGF in relation to renegotiating the provision of existing *connection services*. The Commission established the *Negotiated Transmission Services Principles* in clause 6A.9.1 that require, amongst other things, that the *terms and conditions of access* for *negotiated transmission services* to be based on the costs incurred in providing that service and should be fair and reasonable. Further, clause 6A.9.4 requires TNSP to have in place *Negotiated Transmission Service Criteria* as part of its *transmission determination*. The *Negotiated Transmission Service Criteria* must be consistent with the *Negotiated Transmission Services Principles*. If it can be established that TNSPs do not comply then there would be a compliance issue.

Under the negotiate-arbitrate framework, the Commission provided for a commercial arbitrator to be appointed to resolve transmission service access disputes in relation to the *terms and conditions of access* for the provision of negotiated transmission services.<sup>48</sup> Further, the possibility of an arbitration creates an incentive on TNSPs to negotiate with *transmission network users* consistent with the negotiation framework established in the Rules.

The Commission has not accepted the argument that *connection services* should be distinguished in the manner suggested by the NGF; ie new *connection services* and existing *connection services*.

### **5.6.2 Proposal for TNSP / AER to determine whether grandfathering should cease**

The NGF is seeking to involve the TNSP and the AER in the decision as to whether the services provided under an expiring *connection agreement* are to transition to *negotiated transmission services*.

The role of the AER in the context of the characterisation of services provided by DNSPs is not directly transferable to the transmission context as the circumstances are different. For distribution services, the Rules set out a principles-based approach to determine the form of regulation and the control mechanisms used to determine revenue and prices on a determination by determination basis by the AER. This was intended to accommodate the wide range of jurisdictional arrangements across the national electricity market.<sup>49</sup> This does not apply to the same extent in the context of *transmission services*.

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<sup>48</sup> Refer to clause 6A.9.7 of the Rules.

<sup>49</sup> Minister Hon. P.F. Conlon, National Electricity (South Australia) (National Electricity Law – Miscellaneous Amendments) Amendment Bill, House of Assembly Hansard, 27 September 2007

As set out in the Revenue Determination, the Commission determined that the economic characteristics of connection services are such that end users for these services are likely to be larger and better resourced than the recipients of similar services in the distribution context, providing a counterweight to the market power possessed by the TNSP and making commercial negotiation a feasible proposition.<sup>50</sup> Generators are generally larger and have countervailing bargaining power and so are able to negotiate on a more favourable basis with TNSPs relative to the circumstances recipients of distribution services. Further, the negotiate-arbitrate framework establishes an environment to assist parties in their negotiations. There does not appear to be any need for the involvement of the AER in the transmission context.

There is no explanation provided as to why the TNSP should be the party to request that a service be considered for transition to a negotiated transmission service. Further there appears to be no criteria for the TNSP to adopt in carrying out such a task. The TNSP in this regard could lead to disputes with transmission network users and create uncertainty compared with the clear triggers established in the draft Rule.

The NGF's suggestion would have the effect of slowing down the transition to negotiated transmission services, leaving it up to individual TNSPs in the first instance to submit services to the AER and then relying on the AER to make a decision, taking into account the form of regulation factors. This would create an uncertain and, potentially, inequitable environment. Further, it could contribute to the over inclusion of assets in the RAB. This would be inconsistent with the principles endorsed by the Commission in the Revenue Determination.

The Commission has not accepted the proposal for the TNSP and the AER to determine whether grandfathering of transmission services should cease and, accordingly, the form of regulation to apply.

### **5.6.3 Divisible/ incremental services and transition to negotiated transmission services**

Both the NGF and Grid Australia have raised issues around the divisibility of services. They are similar to option 2. The Commission has set out a number of reasons above as to why it does not support a divisibility of services approach.

However, the rejection of the divisibility concept does raise the issue of how charging should occur where a *connection agreement* is amended or entered into in the middle of a *regulatory control period* which would trigger the end of grandfathering. Both the draft Rule and the Rule as Made provide for grandfathering to end on the commencement of the next *regulatory control period* after a change to the service or connection agreement occurs; this is necessary to preserve the principle that the RAB should only include the value of assets used to provide *prescribed transmission services*.

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<sup>50</sup> Revenue Determination, p xvii

In these circumstances, the Commission would expect that the new or amended *connection agreement* would include the agreed negotiated charges to apply from the commencement of the services but that, until the end of the regulatory control period, the TNSP would only recover those charges to the extent they are not recovered through prescribed charges for the original service. The TNSP and customer are best placed to manage the pricing and cost allocation consequences of a change to the service mid-way through a regulatory control period, and indeed there are incentives for each party to ensure during their negotiations that an appropriate pricing arrangement is reached which fully recovers costs without double-charging. As noted by Grid Australia, the interests of the *transmission network user* would be protected by the requirements of Part D of Chapter 6A.

The Commission acknowledges that implicitly this means a divisibility of a service at a connection point for charging purposes is occurring for a short period until the end of a regulatory control period. However, the Commission does not consider divisibility of services to be a long term option to be provided for in the Rules, due to the complexity of administering such arrangements.

The Commission has not accepted the proposal for inclusion of a divisible services approach.

#### **5.6.4 Use of eligible assets**

The Grid Australia proposal to continue grandfathering where eligible assets can be used to provide a new connection service would be inconsistent with the principle that grandfathering ceases when a transmission network user requests a new or amended service. It would be inconsistent with the Commission's approach to regulating services, rather than the assets that provide the services. The proposal would slow down the transition to negotiated transmission services.

The Commission has not accepted the Grid Australia proposal to continue grandfathering where eligible assets can be used to provide a new connection service.

### **5.7 Commission's preferred approach to grandfathering**

The current grandfathering provisions in the Rules are open to interpretation and have been found to be impractical in their application. The Commission agrees that there is a substantial case for amending clause 11.6.11 to improve its workability as, in its current form, it does not accommodate the legal impediments created by the existence of connection agreements. Further, the operation of the clause is inconsistent with the user focused access arrangements in the Rules. There is also an inconsistency with the Cost Allocation Principles which preclude costs from prescribed transmission services being reallocated to negotiated transmission services.

The Commission acknowledges the NGF's concerns and understands its approach to address its concerns surrounding clause 11.6.11. However, the Commission's assessment, as noted above, is that the NGF's approach in the Rule proposal is not

consistent with the policy intent of the grandfathering provisions. Therefore the Commission does not regard option 1 as its preferred solution to this matter.

Grid Australia's proposal (option 2) to use the expiry of connection agreement presented a workable and logical approach to trigger the end of grandfathering. The expiry of a connection agreement would, in any event, trigger fresh negotiations between the TNSP and Transmission Network User. This seems to be a suitable time for new services to transition from prescribed to negotiated transmission services.

This option addresses the practical limitations relating to existing connection agreements, frequent negotiations, and defining a precise point when grandfathering would cease, which exist under clause 11.6.11 as it is currently drafted as well as option 1.

These features make option 2 preferable to option 1. However, the divisibility aspect of Grid Australia's option was complex and could be problematic to implement, particularly over time. For this reason, the Commission did not consider option 2 as its preferred option, even upon considering the arguments made in its favour in the second round of consultation.

In the Commission's opinion, option 3 has all the advantages of option 2. However, it also provides for a transmission network user initiated change to the service to be a trigger for the end of grandfathering in addition to the expiry or termination of connection agreements. In this regard, option 3 presents a clearer and more workable solution than option 2. Option 3 is also consistent with the principles adopted by the Commission in the Revenue Determination (subject to incidental changes being made).

The Commission understands that some connection agreements do not have defined terms and may continue to exist in perpetuity. In this regard the services to be provided under these agreements will continue to be grandfathered as prescribed transmission services on an ongoing basis. However, it is feasible that in the future the transmission network users who are parties to these agreements will request an amended service. When this occurs the grandfathering of the connection service will end. Nevertheless, the existence of these connection agreements do not, in the Commission's view, mean that expiry or termination of a connection agreement should not be a trigger for the end of grandfathering.

The Commission has taken into account submissions received during the second round of consultation. While generally supportive of option 3, Grid Australia and NGF raised substantive issues that would have the effect of amending option 3 in ways which would provide for less certainty and substantially retard the transition of services from 'prescribed connection services' to negotiated transmission services. The Commission has not accepted the substantive amendments to option 3 suggested by Grid Australia and the NGF for the reasons set out above.

On balance, the Commission has concluded that option 3 is consistent with, and meets, the policy objectives of grandfathering. Option 3 is the Commission's preferred approach to address the NGF's concerns in its Rule Proposal as well as the other issues raised during consultation. Some technical and clarification

amendments have been suggested to improve the drafting of the Rule to implement option 3. These are addressed in Appendix A.

## 5.8 National Electricity Objective

The Rule as Made, like the draft Rule, implements option 3 with amendments as set out in Appendix A. The Commission is of the view that the Rule as Made, like the draft Rule, meets the NEO with respect to efficiency and good regulatory practice and design.

Regarding efficiency, the Commission considers that the Rule as Made:

- allows for a transitioning of prescribed connection services from *prescribed transmission services* to *negotiated transmission services* and thereby narrowing over time the scope of intrusive regulation applying to transmission services;
- allows more commercial negotiation and risks to be transferred to the parties best able to manage those risks;
- offers a clear trigger to allow services provided in circumstances where the TNSP has less market power move out of revenue determinations and to be subject to the less intrusive negotiate/arbitrate form of regulation; and
- allows for better allocation of costs, in that assets for dedicated *negotiated transmission services* would not be paid for by the shared network.

In terms of good regulatory practice and design, the Rule as Made:

- creates consistency and better interaction within the Rules in relation to grandfathering;
- clarifies the current ambiguity in the grandfathering provisions;
- improves the workability and implementation of the grandfathering provisions;
- enhances regulatory certainty and transparency for all parties involved; and
- recognises the existing *connection agreements* established under Rule 5.3.

## **6 Cost allocation, 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 is 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 5. The Commission's consideration includes the matters raised in submissions in response to the Rule Proposal as well as the draft Rule determination and draft Rule.

Comments relating to drafting and technical issues on cost allocation, removal of assets from the RAB and ring-fencing are considered in Appendix A.

### **6.1 Cost allocation**

#### **6.1.1 Issues raised by the NGF**

The cost allocation issue arises because the prescribed connection services are a category of *prescribed transmission services*. As such a category, it is possible that costs can be allocated to prescribed connection services. The NGF is of the view that the current clause 11.6.11 could lead to the shifting of costs from historically 'shared transmission services' to prescribed connection services even though no change to those services has been requested by the generator or customer and there has been no change to the services provided. The NGF believes this can arise in two different ways.

First, a reconfiguration of network assets outside the control of a generator could lead to assets providing shared services being wholly dedicated to providing entry or exit services. In this case, while the services provided by those assets are deemed to be prescribed transmission services under the current rule 11.6.11, the cost of those newly dedicated assets could be reallocated from prescribed TUOS services to prescribed entry or exit services (ie the grandfathered the connection services). While Chapter 6A prevents costs of *prescribed transmission services* being reallocated to *negotiated transmission services*, neither Chapter 6A nor the current clause 11.6.11 prevent reallocation within different categories of *prescribed transmission services*.

Second, as a result of the introduction of Chapter 6A of the Rules, in certain cases, a portion of the costs of shared assets which had previously been wholly attributed to *prescribed TUOS services*, could now be allocated to prescribed connection services.

Again, there is no restriction on reallocation within categories of *prescribed transmission services*.<sup>51</sup>

This could lead to some generators (and large consumers) facing increases in connection charges due to changes in the shared network beyond their control or as result of the introduction of new chapter 6 and even though there is no change to the services being provided . Two outcomes from this are:

- certain generators and customers would face price shocks; and
- the market setting would be one of regulatory uncertainty, resulting in investors seeking higher returns, increased barriers to entry and a detrimental impact on productive efficiency.<sup>52</sup>

This would not be an issue for new generators as *connection services* provided to new generators are classified as *negotiated transmission services*.

### 6.1.2 Description of NGF's Rule Proposal

To address these issues the NGF proposed a Rule which would specifically preserve the cost allocation in respect of prescribed connection services as at the commencement of the Revenue Rule.

The NGF proposed Rule would limit the costs of assets that could be allocated to prescribed connection services to the costs of the assets which were dedicated to the provision of those services on 16 November 2006 (ie the commencement of the Revenue Rule).<sup>53</sup> This would resolve the first and second issues raised above because no new costs could be reallocated to prescribed connection services.

According to the NGF, this limitation would 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.'<sup>54</sup>

A consequential change was also proposed by the NGF to ensure that the TNSP could still recover its full aggregate annual revenue requirement (AARR) from transmission network users. Any portion of the AARR that would have been

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<sup>51</sup> Rule Proposal, pp 6 – 10.

<sup>52</sup> Rule Proposal, p 9.

<sup>53</sup> Rule Proposal, p 3.

<sup>54</sup> Rule Proposal, pp 3–4.

allocated to *entry services* but for the limit described would remain allocated first to *prescribed TUOS services* (up to the stand-alone amount) and second to *prescribed common transmission services*. Consequently, the TNSP would not suffer any revenue shortfall.<sup>55</sup>

The NGF has sought to maintain the market position for 'prescribed connection services' prior to the introduction of the Revenue Rule while preserving the operation of the new priority ordering approach. This, the NGF contended, would improve certainty.

The NGF stated that, if implemented, the Rule Proposal would ensure that costs:

- allocated to prescribed connection services would 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 connection services) would be allocated to *prescribed TUOS services* and *prescribed common transmission services* to ensure that no revenue shortfall occurs for the TNSP.<sup>56</sup>

### **6.1.3 Submissions from first round consultation**

#### **Energy Users Association of Australia**

The EUAA believed that the NGF's Rule proposal shifted the risk of network reconfiguration affecting existing generators away from those generators and onto electricity users. It did not consider this to be appropriate because the assets may not be contributing to shared network services.<sup>57</sup>

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

#### **Major Energy Users Group**

The MEU considered that there must be equity between the costs incurred by current asset users and the costs a new entrant user would have to pay for the same service.<sup>58</sup> It asserted 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

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<sup>55</sup> Rule Proposal, p 4.

<sup>56</sup> The NGF's proposal is made in conjunction with its proposals for clarifying clause 11.6.11 of the Rules. See Rule Proposal p.12.

<sup>57</sup> EUAA submission, 30 April 2008.

<sup>58</sup> MEU submission, 16 May 2008, p.1.

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 did not believe that aiming to avoid price shocks as suggested by the NGF justified an inequitable allocation of costs. It did 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 explained that another way to resolve the NGF's cost allocation issue would be 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 connection services. Grid Australia suggested that clause 6A.19.2(7) of the Rules 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 connection services under Part J of the Rules.<sup>59</sup>

In its supplementary submission Grid Australia stated that it did 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 purposes of Chapter 6A so as to preserve the position which previously applied under old Chapter 6 of the Rules.<sup>60</sup>

It considered 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, clause 11.6.11 should specify the extent of the *transmission system* assets to be regarded as attributable to, or used in, the provision of 'prescribed connection services'.

Grid Australia's approach would ensure that all costs attributable to *prescribed transmission services* be allocated amongst the various categories of *prescribed transmission services*. As a result no amount would be unallocated due to the fact that clause 11.6.11 would define '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

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<sup>59</sup> Grid Australia Initial Submission, pp 6-7.

<sup>60</sup> Grid Australia Initial Submission, p.18.

6A to 'prescribed connection services' (that is, *prescribed entry services* and *prescribed exit services*) would instead be allocated to *prescribed TUOS services*.<sup>61</sup>

## **NGF response to 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's 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 noted that the Rules generally deal with the concept of 'costs' rather than 'assets' being directly attributable to the provision of services.<sup>62</sup>

### **6.1.4 Submissions from second round consultation**

#### **6.1.4.1 Interaction with chapter 6A – clause 11.6.11(c)(1)**

The NGF has suggested that this clause be amended to stipulate that the costs that may be allocated to a prescribed connection service and confines these to the costs of 'eligible assets' that provide that service.

#### **6.1.4.2 Interaction with chapter 6A – clause 11.6.11(c)(2)**

The NGF has suggested some modifications to clause 11.6.11(c)(2) of the draft Rule to make explicit the costs that are to be allocated to prescribed TUOS (as opposed to connection services).<sup>63</sup>

The first category of such costs is costs that would be allocated to 'prescribed connection services' under chapter 6A but are not so allocated due to the cost allocation provision in clause 11.6.11(c)(1).

The second category (ie clause 11.6.11(c)(2)(ii)) is costs that may be reallocated to *connection services* where the relevant asset is used to provide both *connection services* and *network services*, that asset provided *connection services* as at the grandfathering date (or replaces an asset that provided such services as at that date), and the asset is included in the relevant TNSP's RAB. For this second category, costs should not be able to be reallocated from *network services* to *connection services* (or put another way it is appropriate that any such reallocation should increase prescribed TUOS services charges) because, if the relevant asset had been wholly and exclusively used to provide a *connection service*, that *connection service* would be a prescribed *connection service*. There is no reason for according different treatment in terms of the allocation of costs to connection services where the asset would be an eligible asset but for the fact that it is a dual purpose asset.

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<sup>61</sup> Grid Australia Supplementary Submission, p.17.

<sup>62</sup> NGF Submission, p 3.

<sup>63</sup> NGF Second Round Submission, p 25-26

The NGF's concern is that clause 11.6.11(c)(2)(ii) of the draft Rule in using the language 'but for this clause 11.6.11' might be taken as suggesting that clause 11.6.11(c)(2) would only apply to the first category of costs referred to above because clause 11.6.11(c)(1) is the only provision that expressly changes the cost allocation rules in chapter 6A and that clause is limited in its application to eligible assets. This would be inconsistent with the Commission's approach, in the NGF's view.<sup>64</sup>

In its Second Round Supplementary Submission Grid Australia stated that it was difficult to follow the NGF's reasoning for the NGF's suggested redrafting of clause 11.6.11(c)(2). It offered some alternative drafting which it considered would address the NGF's concerns.<sup>65</sup>

### **6.1.5 Commission's analysis of the issues**

The concerns raised by the NGF have been 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.

#### **6.1.5.1 Cost allocation between categories of prescribed transmission services**

The Commission's preferred approach to grandfathering uses a similar conceptual approach to that proposed by the NGF but has been modified to take into account issues raised by Grid Australia. Nevertheless, the Rule as Made addresses the issues raised by the NGF regarding the allocation of costs between categories of *prescribed transmission services*.

Under the Commission's preferred approach, reconfigurations would have no impact on cost allocation in the manner contemplated by the NGF because the assets attributable to prescribed connection services are a limited and confined class of assets; ie, 'eligible assets'. Further, the reallocation of costs could not occur because no new assets can be included in the class of assets defined in the Rule as Made. Similarly, the class of assets comprise only those assets which were wholly and exclusively providing connection services at 16 November 2006 and, therefore, costs from assets providing shared transmission services, some of which might otherwise be allocated to prescribed connection services under Chapter 6A are allocated to prescribed TUOS 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 adopted in the Pricing Determination. This

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<sup>64</sup> NGF Second Round Submission, p 26.

<sup>65</sup> Grid Australia Second Round Supplementary Submission, p 4.

approach is also consistent with the arrangements under the old Chapter 6 of the Rules.<sup>66</sup>

#### **6.1.5.2 Impact of revenue determinations on costs for grandfathered connection services**

The Commission has understood that the Rule Proposal would preclude the application of the pricing arrangements in Chapter 6A to the prescribed connection services. One of the consequences of this proposal would be 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 prescribed connection services.

As a result, the Rule Proposal would not be consistent with the Commission's intention in relation to 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 has concurred 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 Rule as Made (like the draft Rule) provides for 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.

The Commission has accepted the NGF's suggested amendment to clause 11.6.11(c)(1) and it has been incorporated into the Rule as Made.

Regarding the NGF's comments in its Second Round Submission on clause 11.6.11(c)(2), in the Commission's view, the substance of the NGF's comments were

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<sup>66</sup> Pricing Determination, pp 3, 20, 21, 23. The Commission stated that it had substantially maintained the current approach to pricing in the (old) Rules. The causer pays principle applies as a guide to whether, in general, consumers or producers of electricity should contribute towards the recovery of particular costs. The Commission stated 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. As a result, the principle adopted was that generators are to only pay for shallow connection, directly resulting from their connection decisions, as it is consumers that cause the need for network assets.

reflected in the draft Rule, but the Rule as Made does not include “but for this clause 11.6.11”.

Clause 11.6.11(c)(2) is intended to accommodate two different scenarios:

- where assets have never been eligible assets because they were not being “wholly and exclusively” used to provide connection services as at the relevant date, but at some time after commencement of the new rule the assets become dedicated to connection services; and
- where assets have always and continue to be shared between connection services and TUOS services.

In each case, the costs of the assets are to be allocated to prescribed TUOS services. Clause 11.6.11(c)(2) is consistent with both the NGF and Grid Australia positions as set out in their submissions. The Rule as Made clarifies the issues raised by the NGF.

### 6.1.6 National Electricity Objective

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

## 6.2 Removal of assets from the regulatory asset base

### 6.2.1 Issues raised by NGF

The NGF supported the principle in the Rules that prevents the reallocation of costs from *prescribed transmission services* to *negotiated transmission services*. However, the NGF asserted that such a reallocation could 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 considered that this result would be inconsistent with the principles adopted by the Commission in the Revenue Determination. The NGF claimed 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.<sup>67</sup>

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 claimed this would leave the *transmission network user* liable for the full cost of the asset. This would create investment uncertainty for generators.

In addition, the NGF stated that shifting of costs due to the reconfiguration of assets does not align with the shift of the benefit.<sup>68</sup> That is, the service provided to the user may not change. Therefore the NGF considered 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.

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<sup>67</sup> Rule Proposal, p 11.

<sup>68</sup> Rule Proposal, p 11.

### 6.2.2 Description of NGF's Rule Proposal

The NGF's proposed Rule aimed to ensure that an asset could not 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.

### 6.2.3 Submissions from first round of consultation

In its initial submission 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 would 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 was no longer being provided.

Accordingly, Grid Australia considered 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.<sup>69</sup>

### 6.2.4 Submissions from second round of consultation

The NGF has requested an amendment to clause S6A.2.3 to reinforce the Commission's comments regarding the intention of this clause.<sup>70</sup> As the Commission has stated, the intention of clause 6A.2.3 is to provide TNSPs with an incentive to enter into negotiations with large customers. It would be incumbent on TNSPs to enter into commercial negotiations regarding the management of the risk of bypass or disconnection by large network users. If a TNSP does not meet the conditions in clause S6A.2.3 the AER may remove the value of the assets from the RAB.<sup>71</sup> Grid Australia has not endorsed the NGF's suggested inclusion and considers it unnecessary and inconsistent with the principle that a *negotiated transmission service*

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<sup>69</sup> Grid Australia Supplementary Submission, p 8.

<sup>70</sup> NGF Second Round Submission, p 28.

can only be created following a request from a transmission network user and an agreement between that user and the relevant TNSP.<sup>71</sup>

### **6.2.5 Commission’s analysis of the issues**

The Commission has decided to amend the grandfathering provisions to a services, rather than as assets, approach. Under the services approach, a reconfiguration of the assets would 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 the TNSP 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 the TNSP to manage its assets.

The Commission has not accepted the NGF’s suggested amendment to clause S6A.2.3 as set out in its Second Round Submission as it is unnecessary.

## **6.3 Application of Transmission Ring-Fencing Guidelines to cost allocation**

### **6.3.1 Issues raised by NGF**

The NGF 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.<sup>72</sup> 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*.<sup>73</sup> 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*.

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<sup>71</sup> Grid Australia Second Round Supplementary Submission, p 5.

<sup>72</sup> 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*.

<sup>73</sup> 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*”.

### 6.3.2 Description of NGF Rule proposal

The NGF's Rule Proposal would delete clause 6A.19.2(6) and amend 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 sought to ensure that the allocation of costs as between the different categories of transmission services (including *prescribed transmission services* and *negotiated transmission services*) could only be in accordance with the requirements of the *Cost Allocation Principles*.

### 6.3.3 Submissions from first round of consultation

In its initial submission, Grid Australia agreed with the NGF's observations on this issue and supported the NGF's proposed Rule change.<sup>74</sup>

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 regarded 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* could not require allocation of costs between *prescribed transmission services* and *negotiated transmission services*, or between categories of *prescribed transmission services*, in a manner that is inconsistent with the *Cost Allocation Principles*. That is, the AER, in making the *Transmission Ring-Fencing Guidelines*, should not be able to alter the cost allocation approach which Chapter 6A has established.<sup>75</sup>

### 6.3.4 Submissions from second round of consultation

EnergyAustralia supported the Commission's approach to ring-fencing as reflected in the draft Rule and would recommend a similar approach be adopted for distribution.<sup>76</sup>

Grid Australia has suggested that sub-paragraph (2) of clause 6A.21.2(e) of the draft Rule should be deleted because the allocation of costs as between categories of prescribed transmission services is outside the scope of the *Transmission Ring Fencing Guideline*. It went on to state that if the sub-paragraph is retained then the new clause should also refer to the *Pricing Principles for Prescribed Transmission Services* and the *pricing methodology guidelines*<sup>77</sup>.

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<sup>74</sup> Grid Australia Initial Submission, p 9.

<sup>75</sup> Grid Australia Supplementary Submission, pp 7-8.

<sup>76</sup> EnergyAustralia Second Round Submission p 1, 3.

<sup>77</sup> Grid Australia Second Round Supplementary Submission

### 6.3.5 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 related 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 be 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).<sup>78</sup>

The Commission has agreed with the point made by Grid Australia that principles stand at a higher level than guidelines.<sup>79</sup> The intention was for the *Transmission Ring-Fencing Guidelines* to be consistent with the *Cost Allocation Principles* and accepts the comments made in the first round submissions 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*.<sup>80</sup>

The Commission has noted Grid Australia's suggestion to delete references to the allocation of costs as between *categories of prescribed transmission services*. The Commission has not been persuaded by Grid Australia's suggestion and the reference has been retained so as to clearly distinguish the functions of the *Transmission Ring-fencing Guidelines* from the *Cost Allocation Principles*. The Commission has agreed to the suggestion to refer to *Pricing Principles for Prescribed Transmission Services* and *pricing methodology guidelines* as these documents provide for allocation of costs as between categories of *prescribed transmission services*.

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 these documents.

The Commission is of the view that EnergyAustralia's suggestion for the inclusion of equivalent provisions in the distribution context should be the subject of a separate Rule change request.

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<sup>78</sup> Revenue Determination, pp 63- 64.

<sup>79</sup> Grid Australia Supplementary Submission, p 7.

<sup>80</sup> See clause 6A.19.3 of the Rules.

### 6.3.6 National Electricity Objective

The Rule as Made (like 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 Rule as Made 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.

## 7 Transitional provisions and other issues from second round of consultation

This chapter examines new issues raised in submissions from the second round of consultation regarding the application of clause 11.6.11. The issues raised in submissions include provisions to transition to a new clause 11.6.11, *dual function assets* and proposed AER information gathering requirements.

### 7.1 Transitional provisions

#### 7.1.1 Issues raised by Grid Australia

While supportive of the draft Rule, Grid Australia stated that the current clause 11.6.11 (which commenced 18 November 2006) has been applied and has impacted upon certain decisions made by the AER during that period.<sup>81</sup> Grid Australia stated that transitional provisions are required to deal with consequential matters related to the transition from the current clause 11.6.11 to the proposed new clause 11.6.11 and the fact that current clause 11.6.11 has governed the way certain aspects of Chapter 6A have been applied since November 2006.

Grid Australia outlined that *revenue determinations* made by the AER since the commencement date have not uniformly dealt with the allowance which should be made for the replacement of 'prescribed connection service' assets (that is, the proposed replacement of assets which are currently used to provide connection services intended to be grandfathered under clause 11.6.11). To date, in some *revenue determinations*, no allowance has been made for the forecast cost of replacing such 'prescribed connection service' assets.<sup>82</sup> However, under the Rule, an existing service would remain a 'prescribed connection service' even if some or all of the eligible assets which are used to provide the 'prescribed connection services' are replaced on a like-for-like basis.

Accordingly, Grid Australia has requested that further transitional provisions should be included to give an affected TNSP the right to elect to 're-open' a *revenue determination*, a *Revenue Proposal* or any other process under Chapter 6A which has been made or has occurred since 16 November 2006 for the express purpose of requiring the AER to:

- consider what allowance (if any) should be made for the replacement of 'eligible assets' used to provide 'prescribed connection services'; and
- reopen and deal with those processes as if proposed new clause 11.6.11 applied at the time the original processes were undertaken.

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<sup>81</sup> Grid Australia Second Round Submission, p 12

<sup>82</sup> The reason being that the AER considered these to be negotiated and thus falling outside of the revenue cap.

## 7.1.2 Commission's analysis of proposed transitional arrangements

The two aspects of the transitional provisions proposed by Grid Australia relate to:

- reopening or amending current *revenue determination* processes (prior to the issue of a final *revenue determination*); and
- the reopening of an existing *revenue determination*.

The AER has made two *revenue determinations* under chapter 6A (SP Ausnet and ElectraNet)<sup>83</sup> and two *Revenue Proposals* are currently under consideration (Transend and TransGrid). The Commission understands that Grid Australia's proposal is seeking to ensure that TNSPs are able to recover replacement capital expenditure that may have been disallowed by the AER under the current clause 11.6.11.

### 7.1.2.1 Reopening / amending current processes

Grid Australia's proposed transitional provisions would enable certain steps in current *revenue determination* processes to be carried out again. For example, they would enable the TNSPs to resubmit their *Revenue Proposals* and would require the AER to reconsider these. This aspect of the transitional provisions suggested by Grid Australia could be retrospective in application as they seek to affect the *revenue determination* processes already completed and, accordingly, may not be feasible. On one interpretation of the NEL, a Rule change may not apply to existing processes.<sup>84</sup> The proposed reopening of processes currently underway may not be within the Rule making powers of the Commission.

The Commission has not accepted this aspect of Grid Australia's proposed transitional provision.

### 7.1.2.2 Reopening existing revenue determinations

The provision proposed for reopening of *revenue determinations* currently in place would deem the new clause 11.6.11 as an 'event' that satisfies the provisions of clause 6A.7.1(a) of the Rules.

In the Revenue Determination, the Commission provided for a *revenue determination* to be reopened during a *regulatory control period* where an event occurs that sufficiently impacts on the financial viability of the business, or its scope to respond

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<sup>83</sup> Note that PowerLink's revenue determination was made under transitional provisions which required the AER to set PowerLink's revenue cap for the next regulatory period substantially (but not entirely) in accordance with the chapter 6 rules that existed at 3 April 2006 (the old rules) and the AER's Statement of principles for the regulation of electricity transmission revenues (SRP).

<sup>84</sup> Section 104 of the NEL says that a Rule made under section 103 commences operation on the day the relevant notice is published in the SA Gazette or on any day after that day that is provided for in the relevant notice or the Rule. Section 33(1)(b) in Schedule 2 of the NEL states that "the repeal, amendment or expiry of a provision of this Law, the Regulations or the Rules does not (b) affect the previous operation of the provisions or anything suffered done or begun under the provisions".

to unforeseeable circumstances.<sup>85</sup> A TNSP would be able to apply for the reopening of its revenue cap in the event it was obliged to invest in a major project (at least five per cent of the value of its RAB) and that investment would cause the TNSP to exceed its capital expenditure allowance for that entire period.<sup>86</sup> Under clause 6A.7.1, the AER may only revoke a *revenue determination* if the materiality threshold and a number of other criteria are satisfied.

This demonstrates that the Commission intended clause 6A.7.1 to be applied in a limited set of circumstances, relating to significant events. Grid Australia's proposal does not appear to be within the Commission's intent in this regard. The Commission understands that the level of capital expenditure involved for the affected TNSPs would be below the materiality threshold for the purposes of clause 6A.7.1 of the Rules. Therefore the proposal relating to reopening of existing *revenue determinations* is not supported by the Commission.

The Commission acknowledges that some current *revenue determinations* may not make any allowance for the forecast cost of replacing assets used to provide 'prescribed connection services.' To the extent that this is the case TNSPs can include such allowances in their next *Revenue Proposals*, provided that the assets meet the criteria set out in the Rule as Made.

## 7.2 Dual function assets

### 7.2.1 Issue raised by EnergyAustralia

In its submission, EnergyAustralia raised the possible application of the draft Rule to its *dual function assets* (being assets owned by EnergyAustralia as a *Distribution Network Service Provider* (DNSP) but which become part of the *transmission systems* when the support and operate in parallel with the higher voltage transmission network).

EnergyAustralia stated:

'...some of our existing connections to the distribution network may be classified under the grandfathering provisions of 11.6.11, even though they were initially built to support the distribution network.

EnergyAustralia has assumed in these instances that a deemed connection existing between the transmission and distribution networks. This is so that customers who originally connected to the distribution network are not caught under provisions of a negotiated service upon reclassification of the network assets and subsequent replacement...EnergyAustralia would appreciate confirmation of this approach, or if the Commission does not agree with this interpretation, we request the AEMC consider amending the Rules so that dedicated connections to dual function assets that existing at 9

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<sup>85</sup> Revenue Determination, p 60.

<sup>86</sup> Revenue Determination, p 61.

February 2006 are not unduly caught under negotiated services arrangements upon replacement....<sup>87</sup>

## 7.2.2 Commission's analysis of the issue

Currently clause 11.6.11 applies in certain circumstances in determining whether services provided by *dual function assets* are prescribed or negotiated and therefore whether they should be classified as a *standard control* or *negotiated distribution services*. Therefore, this is not a new issue arising from this Rule change request.

Clause 11.6.11 as set out in the Rule as Made applies to 'eligible assets' which are wholly and exclusively providing connection services as at 9 February 2006. First, other than replacements of those assets, this is a closed class so the application of 11.6.11 is limited. Secondly, to the extent *dual function assets* are providing multiple services, they will not be eligible assets and so 11.6.11 will be irrelevant in deciding whether they are to be treated as *standard control* or *negotiated distribution services*.

There should be no practical issues for *dual function assets* providing network to network services, so issues could only arise where a customer is directly connected to a *dual function asset*. The Commission expects this to be a small class.

It is possible, but not necessarily certain, that a cost allocation issue could arise on reconfiguration or the end of grandfathering, that is, because services might change from *standard control* to *negotiated distribution services* at some point. Even if this occurred and an issue arose, it is uncertain as to whether it would be material. If a material issue did arise, there would be mechanisms to address it at the time. The Commission considers it would not be appropriate to include detailed provisions in the Rule as Made for a potential issue, the magnitude of which is not clear on the information provided.

## 7.3 AER Information requirements to monitor grandfathering

### 7.3.1 Issue raised by the AER

The AER noted that grandfathering would cease where a *connection agreement* is amended at the request of the user for the purpose of altering the relevant service. The AER queried whether, under commercial conditions, it would always be clear as to who has initiated the request for the amendment. The AER recommended that the draft Rule be amended in such a manner so that, upon the AER's request, a TNSP could be required to provide the AER with details of every relevant user's request for an amendment to a *connection agreement* and identification of the affected assets.<sup>88</sup>

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<sup>87</sup> EnergyAustralia Second Round Submission, pp 1-2.

<sup>88</sup> AER Second Round Submission, p 2.

### 7.3.2 Commission' s analysis of the issue

Under clause 6A.10.2 of the Rules the AER can make *submission guidelines* in connection with submission of a *Revenue Proposal*. This would appear to be a more appropriate avenue through which its concerns may be addressed. Whether grandfathering applies to particular assets will generally be assessed at the time of submission of a *Revenue Proposal*.

The terms of clause 6A.10.2 are wide enough to permit this information to be covered by the submission guidelines. The Commission suggests that the *submission guidelines* could be amended so as to require any TNSP to include supporting documentation relating to whether particular assets continue to satisfy the definition of eligible assets - and whether services are 'prescribed connection services' - including by requiring the TNSP to submit evidence of negotiations with respect to service alterations or asset upgrades.

The Commission has not accepted the AER's suggested amendment to enable the AER to request a TNSP to provide the details of every relevant user's request for an amendment to a *connection agreement* and identification of the affected assets.

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## A Drafting issues

### A.1 Grid Australia Second Round Submission

#### A.1.1 Definition of 'eligible asset'

Grid Australia suggested a change to the definition of 'eligible asset' to refer to a '*transmission network connection point*', rather than a '*connection point*', to clarify that the relevant point is the point at which the connection assets are physically connected to the network, not merely the point at which the *Transmission Network User's* assets are connected to the *Transmission Network Service Provider's* assets.<sup>89</sup>

Grid Australia stated that different connection agreements deal with the location of the *connection point* in different ways. Some define the relevant point as the *transmission network connection point*; some define it as the point of physical interface between the *Transmission Network Service Provider's* assets and the *Transmission Network User's* assets; and some do not expressly define the relevant point.<sup>90</sup>

Grid Australia then referred to a situation where two *transmission network users* are connected to the transmission network via a common *transmission network connection point* using a combination of shared and fully dedicated *connection assets*. If the term *connection point* was used to determine the eligible assets and was taken to refer to the point at which the *Transmission Network User's* assets are connected to the *Transmission Network Service Provider's* connection assets, then shared *connection assets* could potentially be excluded from the definition of 'eligible assets' because those shared *connection assets* would not be wholly and exclusively used by the *Transmission Network Service Provider* to provide a connection service to a *Transmission Network User* or a group of *Transmission Network Users* at a single *connection point*.<sup>91</sup>

Grid Australia also noted that the use of the phrase '*transmission network connection point*' is consistent with the language of Part J of Chapter 6A in relation to determining the *attributable connection point cost share* for prescribed entry and exit services and allocating the *annual service revenue requirement* for each *category of prescribed transmission services*.<sup>92</sup> The Commission has accepted these suggested amendments and they have been incorporated into the Rule as Made.

#### A.1.2 Permitted amendments to connection agreements

Considering option 3 for grandfathering, Grid Australia stated that it is commonplace for *connection agreements* to be amended by agreement between the

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<sup>89</sup> Grid Australia Second Round Submission, p 2.

<sup>90</sup> Grid Australia Second Round Submission, p.1.

<sup>91</sup> Grid Australia Second Round Submission, p.2.

<sup>92</sup> Grid Australia Second Round Submission, p.2.

parties from time to time for a variety of non-service, commercial reasons or in order to reflect regulatory changes. These amendments would usually not involve any change to the scope of the *connection services* which are being provided under those agreements.<sup>93</sup> Grid Australia has suggested changes to the definition of ‘prescribed connection service’ to clarify that an amendment to a *connection agreement* will only end grandfathering if the amendment requested by the *transmission network user* alters the scope or nature of *connection service*.<sup>94</sup>

The Commission has accepted this suggested amendment and it has been incorporated into the Rule as Made.

### **A.1.3 Connection agreements covering multiple ‘prescribed connection services’**

Grid Australia stated that a number of existing *connection agreements* would cover the provision of prescribed connection services at more than one *transmission network connection point*. Grid Australia has sought clarification that if a *connection agreement* covered the provision of prescribed connection services at more than one *transmission network connection point*, that the if the *transmission network user* requests an alteration to one of these services, the grandfathering would only cease in relation to the altered prescribed connection service.<sup>95</sup>

This is consistent with the Commission’s intent.

### **A.1.4 Connection services provided at a transmission network connection point**

Grid Australia has sought to amend the definition of ‘prescribed connection service’ to refer to ‘a connection service provided by a Transmission Network Service Provider to a Transmission Network User in relation to a *transmission network connection point*’. This is consistent with the amendment to the definition of ‘eligible assets’ above. Further, this covers situations where the *generating units* making up a *power station* are connected to the *transmission network* via the same *transmission network connection points* but have different *connection points*.<sup>96</sup>

The Commission has accepted this suggested amendment and it has been incorporated into the Rule as Made.

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<sup>93</sup> Grid Australia Second Round Submission, p 5.

<sup>94</sup> Grid Australia Second Round Submission, p.5.

<sup>95</sup> Grid Australia Second Round Submission, p 5-6.

<sup>96</sup> Grid Australia Second Round Submission, p 7.

### **A.1.5 Changes to paragraph 11.6.11(c)**

Consistent with its suggested changes to the definitions of 'eligible asset' and 'prescribed connection services', Grid Australia suggested further amendments to clause 11.6.11(c)(1) and clause 11.6.11(c)(2)<sup>97</sup>.

The Commission has accepted the substance of these suggested amendments but has adopted different drafting in the Rule as Made.

Grid Australia initially suggested deleting the words 'and, to avoid doubt, the services provided by those assets which would otherwise be *negotiated transmission services* are taken to be *prescribed TUOS services*'. However, on further analysis, this amendment was considered unnecessary.<sup>98</sup>

## **A.2 Grid Australia Second Round Supplementary Submission**

### **A.2.1 Definition of 'eligible asset'**

Grid Australia suggested that the references to *transmission network user / transmission network users* in the definition of 'eligible asset' should exclude another *network service provider*.<sup>99</sup> In Grid Australia's view while the definition of 'prescribed connection service' would exclude network to network connection services from the scope of prescribed connection services, any existing assets or replacement assets which are wholly and exclusively used to provide connection service to another network service provider would still be classified as eligible assets for the purposes of clause 11.6.11 of the Rules.

The definition of eligible assets is only used in rule 11.6.11 in the context of prescribed connection services and, as Grid Australia points out, network to network connection services are excluded from the scope of prescribed connection services.

The Commission has not accepted this suggested amendment.

### **A.2.2 Definition of 'existing assets'**

Grid Australia agrees with the amendment proposed by the NGF in its Second Round Submission relating to the sub-paragraph (2) of the definition of 'existing assets'. Grid Australia also considers that the final line of the first paragraph of the definition of 'existing asset' should be amended to refer to an existing revenue determination.<sup>100</sup>

This is unnecessary because it is clear that the determination has to exist as at 9 February 2006.

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<sup>97</sup> Grid Australia Second Round Submission, pp 8-9.

<sup>98</sup> See Grid Australia Supplementary Second Round Submission, pp 3-4.

<sup>99</sup> Grid Australia Second Round Supplementary Submission, pp 2- 3.

<sup>100</sup> Grid Australia Second Round Supplementary Submission, p 3.

The Commission has not accepted this suggested amendment.

### **A.2.3 Definition of prescribed connection service – refer to regulatory control period.**

Grid Australia has raised the issue of the date in respect of which the assessment is made under this definition cannot be the day before each regulatory control period commences. In Grid Australia's view, the relevant assessment needs to be made in relation to each TNSP with reference to a day which is just before the due date for submission of that TNSP's revenue proposal. Further it has suggested a change to clause 11.6.11(d) to reflect this; that is, replacing the reference to 'at the start of' with 'in relation to'.<sup>101</sup>

This issue was also raised by the AER. The AER has noted that the definition of 'prescribed connection service' in the draft Rule included a reference to services provided by a TNSP immediately before the start of the TNSP's regulatory control period. The AER has queried the meaning of 'immediately' in this context. If it means the day before the beginning of a TNSP's regulatory control period, it may mean that the AER may not be able accurately to determine the status of a prescribed connection service during the revenue reset process.<sup>102</sup>

The Commission has accepted the substance of Grid Australia's suggested amendment and it has been incorporated into the Rule as Made.

The drafting in the Rule as Made requires that whether a service is a prescribed connection service is to be assessed at *either* the 2009 commencement date *or* the day of submission of a *Revenue Proposal*. So if a service is a prescribed connection service, it attains that status on and from the 2009 commencement date; this is the effect of the words 'on or after the 2009 commencement date' in the definition. The service then remains a prescribed connection service unless, at the date of submission of a *Revenue Proposal*, it has ceased to meet the relevant criteria; if so, then it ceases to be a prescribed connection service at the start of the next *regulatory control period*.

The drafting used in the definition of 'prescribed connection service' has made it unnecessary to change clause 11.6.11(d).

## **A.3 NGF Second Round Submission**

### **A.3.1 Revised definition of existing assets**

The NGF has suggested a modification to clause 11.6.11(a)(1)(ii) to refer to the value of the asset.

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<sup>101</sup> Grid Australia Second Round Supplementary Submission, p 4.

<sup>102</sup> AER Second Round Submission, p 2.

The Commission has accepted this suggested amendment and it has been incorporated into the Rule as Made.

### **A.3.2 Consequential amendments to clauses 6A.19.2(7), 6A.23.2(d) and S6A.2.3(a)**

The NGF suggested amendments to these clauses the effect of which was to include references to other clauses to alert the reader that these provisions are affected by clause 11.6.11.<sup>103</sup>

The Commission has not accepted these suggested amendments as they are unnecessary.

## **A.4 AER Second Round Submission**

### **A.4.1 ‘Prescribed connection service not provided by eligible assets**

The AER has sought clarification on the situation where a ‘prescribed connection service’ may not be entirely provided by using ‘eligible assets’.<sup>104</sup> Situations may arise where a TNSP may wish to add a component part or other device to an eligible asset that would not constitute a replacement for the purposes of the Rules. Similarly the reconfiguration of an asset by a TNSP could result in certain assets which are not eligible assets becoming part of a connection service.

In response to the AER’s comments the following points can be made:

- If a service is provided using eligible assets, but also using some non-eligible assets, it can still be a prescribed connection service. However only the costs of the eligible assets are allocated to that service. The costs of existing or replacements assets that are not eligible assets (including any which, as a result of reconfiguration, subsequently become used to provide the service) are allocated to prescribed TUOS services.
- If a replacement asset has increased or different functionality that is requested by the network user, the asset is not an eligible asset so its cost is not allocated to the prescribed connection service but to negotiated transmission services.
- If a new asset is added that is not a replacement, and is not requested by the network user, it is neither an existing asset nor a replacement asset and is therefore outside the scope of the Rule as Made.

In addition, the Commission is aware that there may be cases in which, while a particular asset would normally be classified for the purposes of Chapter 6A as providing connection services, it has previously (under the former Chapter 6) been treated for cost allocation and pricing purposes as providing TUOS services. To

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<sup>103</sup> NGF Second Round Submission, p 28.

<sup>104</sup> AER Second Round Submission, p 1.

accommodate these situations without causing undue price shocks to customers, the definition of eligible assets has been modified to exclude such assets from being eligible assets. The result of this is that those assets are covered by clause 11.6.11(c)(2) and, where the costs of the assets would normally be allocated to connection services, they will instead be allocated to TUOS services.

## **B Differences between proposed Rule, draft Rule and Rule as Made**

### **B.1 Differences between proposed Rule and draft Rule**

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

First, the NGF's proposed Rule sought 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 sought 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.

## B.2 Differences between the draft Rule and Rule as Made

The key differences between the draft Rule and the Rule as Made are:

- Clause 6A.21.2(e) – the Rule as Made includes an additional sub-paragraph which confirms that Transmission Ring-Fencing Guidelines must not include any provisions which relate to allocation of costs as between prescribed transmission services and negotiated transmission services and categories of prescribed transmission service in a manner inconsistent with Cost Allocation Principles, Cost Allocation Guidelines and the Pricing Principles for Prescribed Transmission Services or the pricing methodology guidelines.
- Clause 11.6.11(a)(3) – the Rule as Made further clarifies the definition of ‘eligible asset’ by reference to a *transmission network connection point*. Further it excludes certain assets from the definition.
- Clause 11.6.11(a)(4) – the Rule as Made clarifies the services that fall into the definition of ‘prescribed connection service’ after the Rule as Made commences.
- Clause 11.6.11(b) – the Rule as Made further clarifies the treatment of costs.

Clause 11.6.11(d) – the Rule as Made confirms that on cessation of grandfathering, the ‘eligible assets’ that provided the grandfathered connection service will cease to be ‘eligible assets’.