3 February 2010

Mr. John Pierce
Chairman
Australia Energy Market Commission
Level 5, 201 Elizabeth Street,
Sydney NSW 2000

By email to submissions@aemc.gov.au

Dear Mr. Pierce,

AEMC Draft Rule Determination - Inter-regional Transmission Charging

Energy & Management Services Pty Ltd (EMS) is an independent consulting firm that has been operating within the energy sector for a decade. EMS provides a broad range of consultancy services to regulators, energy businesses and end use customers.

In this submission, EMS is making representations on the matter of Inter-regional Transmission Charging on behalf of five of its clients, all of whom are large electricity consumers in NSW. These EMS clients are businesses to whom electricity charges represent a very significant production cost.

The AEMC's draft Rule Determination of 2 December 2010 on Inter-regional Transmission Charging (draft Determination) would establish revised Transmission charging arrangements[1],[2]. The EMS clients would all be significantly affected by this proposal, as for them, the Transmission Use of System (TUoS) charge constitutes the whole, or the major component of their network charge.

Notwithstanding that these EMS clients have a direct financial interest in the outcome of this Rule change, the matters that are raised for the AEMC's consideration in this submission relate to sound economic principles and good regulatory practice.

An holistic approach to market development

This Rule on Inter-regional TUoS charges is being progressed at the same time as the AEMC's current Transmission Frameworks review. The MCE Terms of Reference for the Transmission Frameworks review includes the following:

> "*The AEMC shall consider the effectiveness of the existing transmission network charging and access arrangements*. In particular, the AEMC shall consider the development of improved l*ocational signals for generators, and,*

1 Australian Energy Market Commission, Draft Rule Determination - National Electricity Amendment (Inter-regional Transmission Charging) Rule 2010, 2 December 2010.

2 Australian Energy Market Commission, Draft National Electricity Amendment (Inter-regional Transmission Charging) Rule 2010.

if necessary any implications for transmission pricing more broadly, including transmission pricing for load. "[3]

Inter regional TUoS payments arise from interconnector flows between generators and loads in adjacent regions. The Transmission Frameworks review will consider both intra and inter-regional pricing for both generators and loads.

The current Rule change would set in place one aspect of the transmission charging arrangements, which may well be modified as an outworking of the Transmission Frameworks review. In effect, it pre-empts the Transmission Framework review.

It is important that the current Transmission Frameworks review of transmission pricing for generators, including for generators in adjacent regions, should not be forestalled by a decision made now in relation to pricing for loads.

The AEMC should not proceed with this piecemeal approach to reviewing transmission charges. Instead, it should consider Inter-regional Transmission charges for both generators and loads in an holistic manner, in its review of Transmission Frameworks.

Economic efficiency of price signalling

The AEMC's proposal to establish inter-regional TUoS charging includes the recovery of all three components of the TUoS charge:

- Locational (price signalling);
- Non-locational (postage stamped); and
- Common service (postage stamped).

It should be noted that AEMO, Grid Australia and EnergyAustralia all argued in their response to earlier consultation that for reasons of economic efficiency, the inter-regional charge should only constitute the price signalling Locational component. EMS strongly supports their argument and believes the AEMC has not justified the inclusion of Non-locational components. Economically efficient price signals are the way in which the Market Objective will be promoted and postage stamped prices will not achieve this[4].

The Locational (price signalling) TUoS component is intended to influence participant consumption patterns through its associated demand related price structure. On the other hand, the two postage stamped components are not. To reduce distortionary effects on customer consumption patterns, they are generally recovered within a region as an anytime energy-related charge.

To pass on the postage stamped components to an adjacent region will not enhance the economic signalling of charges. These components represent a tax, of which a disproportionate amount is borne by energy intensive industries. That tax recovers the following elements, which vary by jurisdiction:

- Costs associated with sunk and underutilised transmission assets;

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3 Ministerial Council on Energy, AEMC Review of Transmission Frameworks, 20 April 2010.

4 National Electricity (South Australia) Act 1996, as amended.

- Unallocated settlement residues from market operation;
- The recovery of 'prudent discounts' to some large customers, granted under clause 6A.26 of the Rules and in Jurisdictional derogations; and
- The passthrough of costs of disparate Jurisdictional taxes borne by TNSPs, such as the Victorian Land Tax on Transmission Easements[5].

The limited price comparison using 2008/09 data that the AEMC has provided with its draft Determination only serves to highlight the extent to which the postage stamp components would distort economic price signalling. For NSW, the AEMC's analysis shows a net increase in the average TUoS charge of $49.5M, or 5.5%. However if only the Locational components were passed through, the net result would be a *reduction* in TUoS of $0.3M. In effect, the whole of the significant price increase that would be imposed on NSW customers would arise from the non-locational component.

This situation is even more dramatic for Tasmania. If the Locational component of TUoS were passed through, Tasmanians would receive a 2.9% *reduction* in their TUoS charge. The postage stamped components are almost four times this amount and the net result of their inclusion is an 8.1% TUoS increase.

EMS believes that the AEMC's own analysis amply demonstrates the extremely distortionary impact on prices of passing through the non Locational TUoS components and the inappropriateness of so doing.

Impact of the AEMC's regulatory decision

The AEMC's analysis of the pricing effect of the Rule change was limited to consideration of the effect on small customers in NSW. The AEMC concluded that the proposed Rule change would result in a price increase of $1.80 per quarter and:

> "*less than 1 percent increase in the cost of electricity services for some small customers*."

The AEMC has not considered the financial impact of its proposal on large customers. The impact on these customers would be much greater in both dollar and percentage terms, because:

- Their network charge would comprise only TUoS, or have a large TUoS component;
- The energy intensive nature of their operations would expose these large customers to a disproportionate share of the non-locational costs.

Depending upon the customer's load factor and the composition of their network charge, the increase in the Network Use of System (NUoS) charge could well exceed 5.5%. For a Tasmanian customer, it could exceed 8.1%. Price increases of this magnitude could well contribute to making some business operations non-viable.

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5 Victorian Treasurer, Media Release - Government announces end of Electricity Levy, March 24, 2004. The Transmission Easement Land Tax was introduced to recover smelter discounts, following a High Court challenge to the constitutionality of the former Smelter Levy on the wholesale market.

In its regulatory decisionmaking, it is beholden on the AEMC to consider the impact of its regulatory decisions on all classes of customer.

In summary, EMS makes the following recommendations to the AEMC concerning its proposal to introduce Inter-regional TUoS charges for loads:

- The AEMC should not proceed with this proposal in isolation. An holistic review of load and generator charges, including inter-regional charges, has been requested by the AEMC as part of the Transmission Frameworks review;
- The non-locational TUoS components are a tax, to recover sunk transmission costs, discounts and disparate Jurisdictional taxes. They are charged to customers within each region as an energy rate, which already disadvantages energy intensive customers. There is neither rational nor economic justification to exacerbate this problem by passing on the taxes from adjacent regions; and
- The AEMC has failed to adequately consider the impact of its decision on large customers, many of whom would receive a substantial price shock.

If you have any questions in relation to the points made in this submission, I would be pleased to assist.

Peter Halyburton
Managing Director
Energy & Management Services