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22 August 2008

Dr. John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear John,

**Submission to Rule Proposal
Transmission Network Prices Publication Date**

The purpose of EnergyAustralia's submission in response to the above Rule proposal is to:

- Reiterate the rationale for the Rule change; and
- Address the specific comments raised by Grid Australia on 8 August.

Rationale for Rule change proposal

The primary driver of EnergyAustralia's Rule change proposal is how best to allocate the financial risk arising from forecasting transmission prices for customers in the next financial year.

Under current Rules, EnergyAustralia largely bears this risk as a DNSP. If published transmission prices from TransGrid (on 15 May) are higher than EnergyAustralia's estimate used in calculating proposed distribution prices (on 1 May), EnergyAustralia is financially exposed and only fully recovers the difference 24 months after the initial prices are set. EnergyAustralia does not have the information to predict transmission prices for the next year and is forced to base prices on simple escalation of previous year prices in the absence of advice from the TNSP.

Under our Rule proposal, EnergyAustralia will be able to include final transmission prices in its distribution pricing proposal. This will provide better price signals for customers and will significantly reduce the risk EnergyAustralia currently bears which it has no ability to control.

The risk of forecasting error is allocated to the TNSP who will have much greater ability to control forecast risk on transmission prices than DNSPs. However, the risk is minimised because the TNSP is incentivised to provide prices based on the most up to date information. Our recent experiences in preparing distribution prices this year suggest that moving the publication date of transmission prices delivers the more appropriate and efficient balance of

risk and incentives.

Grid Australia's submission on Rule change proposal

EnergyAustralia acknowledges the issues raised in Grid Australia's letter dated 8 August. We appreciate the ongoing co-operation of Grid Australia through TransGrid representatives so as to better understand TNSP's concerns with our proposal.

We note Grid Australia's comments:

"...the accuracy of forecast transmission pricing estimates would come into question with the application of two months less actual data. Particular issues, include:

- less certainty in the calculation of current year and forecast Inter Regional Settlement Residues; and*
- less certainty in the calculation of current year revenue recovery for TNSPs.*

These factors introduce additional price volatility which will impact upon TNSP's 'unders and overs' accounts, and hence distort the accuracy of TUOS prices."

EnergyAustralia acknowledged in its Rule proposal that, should the Rule change proceed, TNSPs would face a lesser degree of certainty in the establishment of prices for the forthcoming year. However, the AEMC must weigh the uncertainty generated by forecasting two months prior to the current date against the current situation under which:

- The DNSP has to make its own assumptions of transmission prices;
- There is no certainty that the calculation of the TNSP prices used for our distribution prices is correct.
- There is additional price volatility which significantly impacts the DNSPs overs and unders account for transmission cost recovery;
- This subsequently leads to unnecessary price volatility for customers.

The DNSP is not in the best position to estimate transmission prices

Under the timing arrangements in existing Rules, DNSPs make their own estimation of the transmission prices for the purpose of their pricing proposal. To do this, EnergyAustralia approaches TransGrid for an estimate of likely transmission charges. TransGrid provides a guide of what their charges are likely to be as a revenue impact to EnergyAustralia for the following financial year.

However this is usually only a high level indication of the likely general increase in charges and does not, for instance cover how these price increases are allocated to various components. EnergyAustralia's current practice in calculating transmission prices to end use customers is to take the existing year's transmission prices and scale them to deliver the DNSP's forecast of likely transmission costs for the forecast year for each tariff class. These prices are submitted to the AER on or before 1 May each year.

EnergyAustralia is fully reliant on TransGrid's advice and its own historic information when setting these prices, and is fully exposed if these initial forecasts prove to be incorrect.

The DNSP is fully exposed to uncertainty in the calculation of transmission prices

If, for example, we assume EnergyAustralia submits distribution prices to the AER for this current financial year and these prices reflect EnergyAustralia's own estimate of a 20% increase in transmission prices. Subsequently, TransGrid releases its transmission prices on 15 May which indicate a 30% increase – 10% higher than EnergyAustralia's estimate. This will leave EnergyAustralia short in the amount of TUoS revenues it recovers from customers (a 10% differential represents around \$15 million of revenue).

Although EnergyAustralia will be able to recover this transmission revenue shortfall through an unders/overs mechanism, it will have an impact on cash flow and year on year EBIT performance delivered by the business. It will take almost 24 months for EnergyAustralia to recover the shortfall. It will also increase prices for customers at the start of the next regulatory control period.

Under existing Rules, the DNSP is exposed to the difference between its own forecast of TNSP prices (required when submitting its distribution pricing proposal on 1 May) and final TNSP prices that are published (on 15 May).

Grid Australia has noted its concerns with greater uncertainty in the calculation of transmission revenue recovery. We understand that the greatest uncertainty faced by some TNSPs relates to payments from Inter Regional Settlement Residues. In receiving information from NEMMCO on quarterly settlement proceeds, TNSPs know 6 blocks of the 16 blocks of the settlement proceeds that they will receive within the next financial year. The forecast uncertainty relates to the last 10 blocks. Therefore, the level of uncertainty in forecasting settlement residues relates only to a portion of the forecast year.

EnergyAustralia maintains that while there is less certainty for the TNSP in calculating prices at an earlier date, as a result of the proposed Rule change this is still preferable to the DNSP calculating forecast transmission charges with relatively no information.

There is significant uncertainty that transmission prices calculated by EnergyAustralia reflect the prices that will be finally published by TransGrid on 15 May. Our Rule proposal brings forward the transmission price publication date to 15 March to allow EnergyAustralia to include final transmission prices in its pricing proposal.

Customer Impact

As noted in our rule change proposal, customers do not receive a true reflection of transmission prices for the year and large movements in overs and unders balances are passed through to customers in terms of price volatility. To suggest that bringing forward the publication date would distort the accuracy of TUoS prices seems curious, as only two or three directly connected TNSP customers actually face these prices. All other customers who are connected to a DNSP see the previous year's prices calculated by DNSPs (scaled up). DNSPs cannot in themselves respond to price signals, they can only pass them on to end use customers who drive the demand that TNSPs see on their network.

Further discussions on Rule change proposal following Grid Australia's letter

EnergyAustralia and Grid Australia representatives have been discussing how best to progress issues raised in the 8 August letter. In particular, we have discussed alternative publication dates which may balance the information needs of transmission and distribution businesses. EnergyAustralia believes that 6 April is probably the last date for which transmission prices can

be published and can practically be included in a DNSP pricing proposal (allowing for internal sign-off processes to occur). This would give TNSPs additional certainty on March quarter results of settlement surpluses when establishing forecast prices. We understand that a large part of the uncertainty in forecasting transmission prices is resolved if TNSPs have the March quarter settlement surpluses available.

EnergyAustralia agrees with Grid Australia that the Rule change proposal will change some reporting requirements and approaches to forecasting. EnergyAustralia already provides the information TransGrid requires as a co-ordinating TNSP. EnergyAustralia is incentivised to provide whatever information is needed to ensure the co-ordinating TNSP can meet the earlier publication date. EnergyAustralia sees no barrier to providing the information earlier, should TransGrid require more lead time to finalise transmission prices by an earlier date. Clause 6A29.1 already places obligations to provide information to the coordinating TNSP within each region.

We also understand that Grid Australia's response to the Rule proposal includes a recommendation for a list of "pre-conditions" which it requires before it can publish prices. While this assists in our understanding of information required for calculating transmission prices, this Rule change focuses on the publication date of transmission prices rather than the information requirements of TNSPs with which we already comply.

EnergyAustralia's Rule change notes the additional complexity in providing prices in the first year of a regulatory control period. Grid Australia raises the additional issue of implementing the transmission pricing methodology, given the AER determination will not be finalised by the time of publication. EnergyAustralia accepts that as a transitional measure, the AER determined transmission pricing methodology would not be available in the first year of the period.

We look forward to further discussions with the AEMC to clarify any issues with our proposal.

If you have any enquiries in relation to this matter please do not hesitate to call me on on (02) 9269 4171.

Yours sincerely,

A handwritten signature in blue ink that reads "Catherine O'Neill". The signature is written in a cursive, flowing style.

CATHERINE O'NEILL
Executive Manager – Network Pricing & Regulation