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Dr John Tamblyn  
Chairman  
Australian Energy Market Commission  
PO Box H166  
Australia Square NSW 1215

By email to: [submissions@aemc.gov.au](mailto:submissions@aemc.gov.au)

Dear Dr Tamblyn

### **Review of the Electricity Transmission Revenue and Pricing Rules**

AGL is pleased to provide comment on the scope of work that the AEMC proposes to undertake to review issues surrounding transmission in the National Electricity Market (NEM), while fulfilling the obligations set out in section 35 of the National Electricity Law. AGL is a generator, retailer and distribution network service provider in the NEM and therefore able to comment on this issue from all viewpoints.

It is important to take an integrated view of the role of transmission in reviewing the National Electricity Rules. This is because costs associated with transmission involve more than charges of transmission network service providers. The costs also include the market costs or indirect costs. There is unfinished work which impacts on the market costs or indirect costs. This unfinished work is largely set out in the MCE Statement on NEM Electricity Transmission. Accordingly, AGL believes that this unfinished work should be included in the scope of the review and that this work should be completed before the AEMC considers pricing regulation.

An orderly and efficient approach to the development of pricing regulation should not involve investigation of matters that have already been the subject of extensive consultation. Pricing for regulated infrastructure has been the subject of comprehensive work by the Productivity Commission (PC) in its review of the National Access Regime and the results of this review agreed (with minor modification) by the Commonwealth and State and Territory Governments. The position adopted by the Government for the National Access Regime has now largely been adopted by the PC in its review of the Gas Access Regime. Accordingly, the package of the PC's recommendations on the Gas Access Regime should be implemented and the AEMC should use the amended Gas Access Regime as the basis for dealing with pricing regulation in electricity transmission.

AGL therefore believes that the scope of the AEMC review should be expanded to include the matters set out in the MCE's Statement on NEM Electricity Transmission and other unfinished reviews under the previous National Electricity Code and these matters should be considered first by the AEMC. Consideration of pricing regulation should be deferred until after these matters have been considered and until after the package of recommendations from the PC on the Review of the Gas Access Regime have been implemented.

If you have any queries, please contact Alex Cruickshank, Manager NEM Development on (03) 9201 7694.

Yours sincerely,

Electronic copy

Dr Robert Wiles  
General Manager Regulation and Policy

# **AGL submission to the AEMC on the scope of its review of the Electricity transmission revenues and pricing Rules**

## **EXECUTIVE SUMMARY**

1. Transmission is pivotal to the operation of the electricity market since it impacts on both the direct costs of transmission and on costs not directly related to transmission charges. To ensure that the full economic impact is addressed, it is therefore important to take an integrated view of the role of transmission in the electricity market. The resulting regulatory framework for transmission must provide pricing and other signals that will facilitate the economically efficient operation of the market.

Much of the work that is yet to be completed in transmission regulation relates to the indirect impact of transmission on market costs. Some of this work was set out in the MCE Statement on NEM Electricity Transmission, released in May 2005, while others were included as reviews in the National Electricity Code. Because of the importance of these market costs, AGL believes these matters should form the main effort in this review.

2. An orderly and efficient approach to development of pricing regulation for energy infrastructure should not involve investigation of matters that have already been the subject of thorough consultation. Pricing for regulated infrastructure has been the subject of the exhaustive work of the Productivity Commission (PC) in its Review of the National Access Regime (NAR), and the results of this review have been agreed (with minor modification) by Governments. The Governments position on the NAR has now largely been incorporated by the PC in its review of the Gas Access Regime (GAR). The package of the PC's recommendations on the GAR should therefore be adopted and implemented by Governments. The AEMC should then use the amended GAR as the basis for dealing with pricing regulation in electricity transmission.
3. For these reasons, the scope of the AEMC review should be expanded to include all matters that were addressed in the MCE Statement on NEM Electricity Transmission and all outstanding reviews from the National Electricity Code. In addition, some aspects of generator access have not worked efficiently and should be included in the scope of this review.

The unresolved issues relating to market need to be addressed first since the regulation of networks should support efficient market outcomes. Pricing principles (revenue determination and pricing) should not be considered until after these market issues have been resolved and until after the package of recommendations from the PC on the review of the GAR has been implemented. Until that time, the AEMC should make the rules required under Section 35 of the Law based on the current processes and procedures that are used in the NEM.

## 1. AN INTEGRATED VIEW OF THE PROBLEM

The role of transmission in the electricity market is pivotal. Getting transmission revenue determination, pricing and investment and operational incentives correct is fundamental to economic efficiency and to minimise the overall cost of electricity to customers. The final cost of electricity to customers is the sum of the costs incurred at each step in the supply chain: Energy + Transmission + Distribution + Retail, where:

*Energy cost* is the cost of creating the electricity plus the costs of sale, which includes management of the volume and price risk. Energy costs for a customer are also increased by dispatch inefficiencies, where more expensive plant is used due to network constraints.

*Transmission cost* is the cost of building, operating and maintaining the transmission network to transfer the energy from generators to the distribution network. Spending either too much on transmission or too little, or spending it in the wrong places, can adversely impact the market.

*Distribution* is the final physical link to customer and needs to be delivered efficiently. It does not, however, have market impacts and is not further considered.

*Retail costs* are the costs involved in the delivery of energy at contracted prices and involves bulk purchase of energy, tailored contracts and the management of risk. Factors that reduce the ability of retailers to contract with generators or that increase the riskiness of energy prices increase retail costs since the risk needs to be factored into prices.

Transmission has to be considered therefore in the context of its market impacts as well as direct costs. In AGL's view, three elements need to be addressed when considering costs of transmission:

- **Augmentation.** What mechanisms are required to manage how the transmission network is upgraded and expanded? How is transmission network augmentation balanced with generation and demand side alternatives? Who should pay for augmentation, particularly inter-regional augmentation?
- **Operations.** How should the TNSPs interact with the market? How are constraints defined and how is their impact on market outcomes managed? A key problem at present is that TNSPs are not exposed to the risks they create in the market or the price impacts they cause.
- **Revenue and pricing.** How and from whom should transmission network costs be recovered? What rights and service levels do parties get for Transmission Use of Service (TUOS) payments? Currently all shared transmission network costs are levied against customers, although some movement is being made to charging beneficiaries for new investments.

The scope of the AEMC review and the process followed by the AEMC should be such that these matters can be considered in an appropriate sequence.

## 2. CONSISTENCY WITH THE NATIONAL ACCESS REGIME AND THE GAS ACCESS REGIME

AGL understands that the review of transmission revenues and pricing must address the issue of appropriate pricing regulation. However, an orderly and efficient approach to development of pricing regulation for energy infrastructure should not involve investigation of matters that have already been the subject of thorough consultation.

AGL welcomes the AEMC's identification of potential duplication in other reviews or MCE initiated programs. The PC, for example, has carried out extensive reviews of appropriate pricing principles through its review of the National Access Regime. The Commonwealth and State and Territory Governments have agreed (with minor amendments) to implement the recommendations of this review. The recommendations of the PC in its review of the Gas Access Regime have largely incorporated those agreed by the Governments. The package of the PC's recommendations on the GAR should therefore be adopted and implemented by the Governments. Then, the AEMC should use the amended GAR as the basis for dealing with pricing principles in electricity transmission.

## 3. SCOPE AND TIMETABLE OF THE REVIEW

### 3.1 Scope

AGL supports the AEMC's view that the review needs to be wider than that outlined in Section 35 of the Law. We note that the MCE Statement on Transmission indicated that a Terms of Reference is to be issued for this review and that many outstanding matters will be referred to the AEMC. We also note that there have been a number of reviews into transmission where the recommendations have not been fully implemented. Finalising these outstanding matters an integrated manner should be the AEMC's focus. AGL's comments against the specific questions in your paper are attached to this submission.

AGL accepts that the Law obligates the AEMC to make rules in relation to specific aspects of transmission regulation under Section 35 of the Law. The issues include revenue determination, price setting, procedures for price reviews and performance standards for transmission companies. These issues are, in the main, settled in the NEM and incorporated in the ACCC Statement of Regulatory Principles. The Law does not require review of these principles and, since they have been fully consulted, they should be simply adopted into the Rules using the standard Rule change process. The remainder of the areas covered by Section 35 of the Law could similarly adopt current processes of the ACCC unless they are demonstrably unworkable. This approach would allow the AEMC to devote its main efforts to unresolved issues.

AGL considers that the main effort in this review should be to review unresolved issues in augmentation and operation, such as generator access and performance standards. The AEMC must also support the issues identified in the MCE Statement on Transmission, such as region boundaries, inter-regional risk and the regulatory test. In essence, the AEMC needs to complete the work of the NECA Transmission and Distribution Pricing Review, the Firecone Study and the CRA review into Region Boundaries. AGL believes that the key areas to be examined are:

- **Beneficiary Pays and firm access.** The issue of who pays and what is provided for that payment is central to transmission reform. Work to finalise the beneficiary pays regime was halted by Governments in 2002. This work needs to be finalised so that appropriate charges can occur for network development, particularly inter-regional developments. This is an

important area of reform that should be included in the scope of this review. Similarly, firm access for generators and for customers to interconnectors needs to be added to the scope of this review.

A related issue is charging generators the cost of their connection to the NEM. Rule 5.5 is designed to ensure that connecting parties pay the full costs of connection to the NEM (or pay compensation for reduction of access to others). This rule should provide some measure of firm access for parties in the NEM as well as ensure economic expansion to meet generators needs but has not proved effective in the NEM. It needs to be made effective and AGL believes it appropriate for it to be included in the scope of this review.

- **Regulated Augmentation.** Augmentation of networks using the regulatory test has not proved an easy task and it has attracted a lot of criticism. While there has been much augmentation, most has been the result of reliability augmentation. Examining methods to ensure appropriate and balanced investment in transmission should be a key task of the AEMC. While refining the regulatory test is one step, a fresh look at the approach is essential. Accordingly, this issue should be included in the scope of this review.
- **Operations.** The actual performance of the network is critical to the NEM. This work should be included in the scope of the review and the AEMC should move to develop a market impact measure to be included in the Rules. It is worth noting that an ACCC working group has started this work and this could be used as a basis for the AEMC work.
- **Regional boundaries and inter-regional risk management.** Managing the risk of trading across regional boundaries remains a key issue in the NEM. While solving the operational and augmentation issue in the transmission sector will reduce the impacts of boundaries on the NEM, we believe the AEMC needs to finalise this issue.

The AEMC should move quickly to implement the Rule changes that the MCE will provide, as stated in the MCE Statement on Transmission.

### **3.2 Timing**

Expanding the scope in the way suggested by AGL could still be achieved in the timeframe planned by the AEMC. The work could be carried out in three streams:

- **Section 35 review (Rules).** Work to incorporate the current processes and procedures of the NEM into the Rules. This would include incorporating the Statement of Regulatory Principles and current review processes and would cover off almost all of the Section 35 material. This stream could also cover the Rules provided to the AEMC as a result of their consultations on transmission, such as region boundaries. This work should be mainly administrative and should be complete by July 2006
- **Regulated Augmentation and Operation.** Work to examine augmentation and operation of the networks. This group should be focused on the market impacts of these decisions and the most cost effective methods to ensure the long term interests of customers are achieved. This work should commence early in 2006 and be completed by the end of the year.

- **Beneficiary Pays, Firm Access and Inter-regional risk.** Work to review the beneficiary pays, firm access and clause 5.5 issues. This is primarily to complete the NECA transmission and development work but also should examine the efficiency of current generator access. This work needs to be completed before the final work on augmentation and operation since that work will need to follow a consistent pattern. This work will need to be completed no later than July 2006

Revenue and pricing would be considered once the MCE has responded to the PC's recommendations on the GAR.

### **3.3 Use of Industry Working Groups**

AGL considers that major reviews are most successful when industry is involved at an early stage. We therefore consider that the AEMC should establish relevant groups as soon as possible. One group should be assigned to each stream of work, with a common AEMC staff to ensure consistency.

## **Review of the Electricity Transmission Revenue and Pricing Rules Specific questions in the Scoping Paper and AGL's response**

### **3.1 Chapter 5 Issues**

***The Commission invites comment on the relevance of each of these Rules to this Review and whether there are other Rules which are beyond the scope of this Review but which may be relevant to it.***

AGL considers that chapter 5 matters should form a substantial part of the review. We consider that the review must encompass:

- The Regulatory Test;
- Network planning and performance;
- Generator access (clause 5.5)
- Constrained payments (clause 5.5).

### **3.2 Market Network Service Providers**

***The Commission invites comment on whether, and to what extent the Rules that provide for non-regulated transmission systems may be relevant to specific matters in this Review.***

AGL considers that this issue was adequately dealt with in the Firecone Study and should not be further reviewed.

### **4.2 Form of regulation**

***The Commission invites comment on whether, in the light of the NEM objective and the requirements of s.35(3), this Review should consider alternative approaches to the current CPI-X building block approach.***

AGL considers that this debate should be delayed until after the National Gas Access Regime is resolved and should be examined in the light of incorporating regulation of gas and distribution in the National Electricity Rules.

### **4.3 Mechanism for establishing the revenue requirement**

AGL considers that matters such as Asset base and criteria for determining efficient investment, depreciation, return on investment and operating expenditure should be deferred until the PC Gas access review is resolved. Until then the approach outlined in the ACCC Statement of Regulatory Principles should be converted into Rules.

The AEMC should focus on examining the incentive mechanisms on transmission owners for augmentation and operation during this review. This should include how the Rules treat non-transmission alternatives, such as demand side response and embedded or distributed generation.

### **5.3 Matters in existing Rules**

***The Commission invites comment on whether it should be seeking to simplify and clarify the transmission pricing objectives and principles in the course of the Review.***

AGL considers that this should not be an aim of this review but possibly the outworking of the implementation of the PCs review of the Gas Access Regime.

***The Commission invites comment on whether this Review should address the range of charges ... [entry, exit, general etc] .***

This matter was fully addressed during the NECA review into transmission and distribution pricing and should not be further reviewed by the AEMC.

***The Commission invites comment on whether this Review should consider the degree of flexibility retained by transmission system operators to determine the structure of charges, and whether alternative structures should be considered.***

This matter was fully addressed during the NECA review into transmission and distribution pricing and should not be further reviewed by the AEMC at this stage. This matter should, however, be addressed in the later review into infrastructure pricing after the PC review into gas access pricing is resolved

***The Commission invites comment on whether this Review should consider interregional TUoS transfers.***

The Rules currently allow for inter-regional TUoS transfers under Rule 6.7.3(d). This matter was fully addressed during the NECA review into transmission and distribution pricing and should not be further reviewed by the AEMC.

***The Commission invites comment on whether this Review should consider avoided TUoS rebates.***

The Rules currently allow for avoided TUoS rebates under clause 5.5. This matter was fully addressed during the NECA review into transmission and distribution pricing and should not be further reviewed by the AEMC.

The issues that remain in relation TUoS rebates relate to TNSP pricing to DNSPs not the mechanism. This may be addressed by the inclusion of the ACCC Statement of Regulatory Principles in the Rules.

***The Commission invites comment on whether this Review should consider the allocation of shared network costs between users of the transmission system.***

AGL considers that this issue should be a major focus of the AEMC review. The concepts of beneficiary pays and generator access charging have not been appropriately dealt with in the NEM and need full review. The NECA review into transmission and distribution pricing commences reviewing this matter and should be completed as part of this review.

***The Commission invites comment on whether this Review should consider the methodology(ies) for determining shared network usage charges.***

This matter was fully addressed during the NECA review into transmission and distribution pricing and should not be further reviewed by the AEMC.



## **6. Regulatory Discretion**

***The Commission invites comment on whether this Review should consider the appropriate balance between discretion and prescription when the AER is making a transmission determination.***

AGL understood that the purpose of section 35 of the Law and clauses 15-24 of Appendix 1 to the Law was to limit the flexibility and discretion of the AER. As such the AEMC should incorporate the existing ACCC regulatory principles and processes in the Rules. AGL considers that this matter should, however form part of the later review into infrastructure pricing after the PC review into gas access pricing is resolved.