grid australia
BACKBONE OF THE NEM

25 February 2011

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

Via website: www.aemc.gov.au

Dear John,

Inter-regional Transmission Charging Draft Rule Determination

Grid Australia makes this submission in response to the Australian Energy Market Commission (AEMC) Inter-regional Transmission Charging Draft Rule Determination.

Grid Australia has actively engaged with the AEMC and policy makers to ensure that the proposed inter-regional transmission charging regime is able to be practically implemented.

Consistent with its previous submissions Grid Australia supports the implementation of a load export charge based on the locational component of prescribed transmission prices.

Grid Australia acknowledges the changes made in the draft rule determination which address many of the concerns highlighted in the previous phase of this consultation. Notwithstanding this a number of key issues remain, which require attention prior to the making of the proposed Rule. The following issues are addressed in the attached submission:

- Inclusion of the postage stamped components of prescribed transmission prices;
- Passing through of significant state based taxes and levies to adjacent jurisdictions;
- The ability to achieve the proposed commencement date of 1 July 2012;
- Methodology for the redistribution of settlement residue auction (SRA) proceeds to customers on a locational basis; and
- Aspects of the unders and overs mechanism for inter-temporal adjustments.

A set of drafting comments is also attached.

Grid Australia would welcome the opportunity to work with the AEMC on specific aspects of the draft Rule prior to it being finalised.

For further information please contact Bill Jackson on (08) 8404 7969 or me on (08) 8404 7983.

Yours sincerely,

Rainer Korte
Chairman
Grid Australia Regulatory Managers Group

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BACKBONE OF THE NEM

Inter-regional Transmission Charging Rule 2010

Response to AEMC Draft Rule Determination

25 February 2011

Powerlink Queensland
TransGrid
ElectraNet electricity transmission
TRANSEND
SP AusNet A member of Singapore Power Group

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1. Background

Grid Australia makes this submission in response to the AEMC's Inter-regional Transmission Charging Draft Rule Determination.

Grid Australia and its members have participated in the development of the NEM transmission pricing arrangements since their inception. Grid Australia has actively engaged with the AEMC and policy makers to ensure that the proposed inter-regional transmission charging regime is able to be practically implemented.

Consistent with its previous submissions Grid Australia supports the implementation of a load export charge based on the locational component of prescribed transmission prices.

2. Introduction

Grid Australia acknowledges the changes made in the draft rule determination which address many of the concerns highlighted in the previous phase of this consultation. Of particular note is the decision to maintain a principles based approach to transmission pricing with the specific implementation issues to be dealt with by first amending the AER pricing methodology guideline and subsequently TNSP transmission pricing methodologies.

Notwithstanding this a number of key issues remain, which require attention prior to the making of the proposed Rule and these will be addressed in turn.

- The inclusion of the postage stamped components of prescribed transmission prices.
- The passing through of significant state based taxes and levies to adjacent jurisdictions.
- The ability to achieve the proposed commencement date of 1 July 2012.
- The methodology for the redistribution of settlement residue auction (SRA) proceeds to customers on a locational basis.
- Aspects of the unders and overs mechanism for inter-temporal adjustments.

Grid Australia would welcome the opportunity to work with the AEMC on specific aspects of the draft Rule prior to the final determination.

3. Key Issues

3.1 The inclusion of the postage stamped components of prescribed transmission prices

Inconsistent with the economic efficiency principles of the NEM

Grid Australia remains firmly of the view that the load export charge should be based on the locational component of prescribed transmission services only. As noted in our previous submission, inclusion of the postage stamped components, as currently proposed, is likely to result in the importing regions contributing significantly beyond the long run marginal cost of the existing and new transmission assets supporting inter-regional flows. This is inconsistent with the economic efficiency principles that underpin the National Electricity Objective.

As noted in our previous submission, the postage stamping mechanism was intended to provide the least economically distorting means for recovering the non-locational costs associated with delivery of the relevant services. It was not intended to allow the recovery of costs that had only a tangential (or zero) nexus with the use of the adjoining region's transmission system assets, particularly if this resulted in the charges paid by importing customers in one jurisdiction being materially higher than those faced by customers in the exporting jurisdiction.

Doing so would run counter to the purpose of having an interconnected national market and ignore the significant benefits accruing to customers in the exporting region provided by the relevant system assets in the importing region. This includes the sharing of generation reserves and the additional frequency control ancillary services (FCAS) made possible by interconnection. Another benefit is the additional spinning reserve available to manage low system inertia, conditions more applicable to the South Australian and Victorian regions due to their higher proportion of wind generation.

Significant volatility due to highly variable energy flows

One of the benefits of the Basslink interconnector between Victoria and Tasmania was to 'drought-proof' Tasmania due to its heavy reliance on local hydro generation. Energy flows across Basslink between 2008-09 (a drought year in Tasmania) and 2009-10 (a non-drought year) reveal the significant volatility of flows across this interconnector, in this case caused by drought. As noted in the following table, between 2008-09 and 2009-10 the energy exported from Tasmania increased nine fold while the energy imported into the State fell by a third.

	2008-09	2009-10
Tasmania to Victoria	79.1 GWh	711.5 GWh
Victoria to Tasmania	2,645.5 GWh	1,796.1 GWh

Consistent with the treatment of the notional interconnectors as load connection points the postage stamped components of the export charge will be based on the energy flows on, rather than the capacity of, the interconnectors. This is due to the load factor of the interconnectors which will be below the median for loads in each region.

The result of this approach will be significant volatility in the postage stamped components of the export charge from year to year due to the high level of variability in interconnector flows. It is not appropriate to deal with the volatility of the postage stamped components by requiring them to be charged on a capacity basis as this would significantly overstate the charge. The locational component will not exhibit this same level of volatility due to the way in which it is calculated.

This reinforces Grid Australia's concern that the inclusion of the postage stamp components in the load export charge will lead to significant volatility from year to year, which will have a material detrimental impact on customers. Modelling using the 2008-09 energy flows across Basslink indicates that an additional 7.8% in transmission charges would be recovered from Tasmanian customers for the load export charge, compared with a reduction of 0.2% if the 2009-10 energy flows were modelled – an 8% reversal arising from the inclusion of the postage stamp components.

3.2 The passing through of significant state based taxes and levies to adjacent jurisdictions.

During the analysis coordinated by Grid Australia for the AEMC it was noted that the prescribed common service charges being calculated by AEMO for the Victorian regime were significantly higher in proportion to the locational and non-locational components than was the case for the other NEM jurisdictions.

Subsequent to this analysis it became apparent that this significant increase in the common service charge from Victoria was due to the passing through of a significant state based tax to consumers via this component.

With respect to this tax we understand that:

- From 1997 to 2004, the Victorian Government imposed a charge (known as the 'Smelter Reduction Amount') by way of a levy on the wholesale electricity market in Victoria.

- In 2003, a subsidiary of Smorgon Steel instituted a High Court challenge to the validity of the Smelter Reduction Amount. As a result of the challenge (although, as we understand it, before any High Court ruling on the validity of the levy was made) the Victorian Government abolished the Smelter Reduction Amount. At the same time, the Victorian Government imposed a land tax on electricity easements owned by Transmission Network Service Providers in Victoria as a means of recovering the revenue foregone as a result of the abolition of the Smelter Reduction Amount.[1]

- In 2004 the Victorian Government amended the *Valuation of Land Act 1960* (Vic) and the *Land Tax Act 1958* (Vic) (which is now the *Land Tax Act 2005* (Vic)) to require electricity transmission companies to pay land tax on the transmission easements held by them (Easement Land Tax).

- The Easement Land Tax is currently being passed through to Victorian electricity consumers via charges for prescribed common transmission services. This pass-through amount was $93 million in the 2010-11 financial year.

- Under the proposed inter-regional transmission charging regime, it is anticipated that approximately 20% of the Easement Land Tax could now be passed through to consumers in other NEM jurisdictions.

The passing through of this or other significant state based taxes to customers in adjacent regions is inappropriate. The inclusion of taxes such as the Easement Land Tax in the charges which are to be re-allocated in accordance with the proposed inter-regional transmission charging regime would, in fact, result in consumers in other States cross-subsidising customers in Victoria, for a portion of a Victorian based revenue raising measures which is unrelated to the transmission of electricity within Victoria.

Perversely the introduction of a proposed inter-regional transmission charging regime which re-allocates a portion of the Transmission Land Tax to consumers located outside of Victoria would actually decrease the costs which would otherwise be payable by a consumer who chooses to locate its business/load in Victoria.

It could be argued that the Easement Land Tax is not a cost which is reflective of efficient investment in electricity infrastructure. It is a tax which was explicitly introduced by the Victorian State Government as a replacement source of revenue and is required for reasons unrelated to the transmission of electricity within Victoria.

[1] A media release from the then Premier of Victoria dated 24 March 2004 explicitly linked the abolition of the Smelter Reduction Amount with the imposition of land tax on TNSP owned easements.

By passing a portion of that tax through to consumers located outside Victoria, the proposed inter-regional transmission charging regime is actually making it more attractive (in theory) to locate a load in Victoria. This is not an efficient locational signal.

Grid Australia would argue that, while it is not an efficient cost, it is a cost which is incurred by the relevant TNSP in that jurisdiction which must be recovered solely from customers of that jurisdiction.

Grid Australia proposes that:

- significant State based taxes (such as the Easement Land Tax) should be identified as 'operating and maintenance costs' incurred in the provision of prescribed common transmission services and excluded from the aggregate annual revenue requirement (AARR) in accordance with clause 6A.22.1(2) of the Rules;

- the AER pricing methodology guideline be required to define a practical threshold to assess the materiality of state based taxes and charges and that pricing methodologies be required to address the treatment of these taxes and charges; and

- charges for prescribed common transmission services should not form part of the proposed inter-regional transmission charges.

Removing significant State based taxes and charges from costs which are to be allocated under the proposed inter-regional transmission charges regime would not prevent a TNSP from recovering these fixed costs. All it would mean is that TNSPs would continue to recover these costs in the same manner as has applied to date, namely from customers in the jurisdiction or region which imposes the tax.

3.3 The ability to achieve the proposed commencement date of 1 July 2012

The AER and TNSPs ability to implement

Grid Australia notes the AEMC decision to maintain a principle based approach to transmission pricing with the specific implementation issues to be dealt with by amending first, the AER pricing methodology guideline and subsequently, the pricing methodologies of the TNSP's.

Grid Australia is however concerned that the commencement date of 1 July 2012 specified in the draft rule significantly underestimates the complexity of the task of introducing the inter-regional transmission charging regime.

Further, it does not leave sufficient time for a considered approach to the amendment of the pricing guideline by the AER, or the development and review of the associated

pricing methodologies and pricing models by the TNSP's. For example, Grid Australia considers that it is important to ensure that the revised Pricing Guideline does not contain any unintended consequences and to the extent practicable, enables all TNSPs to be subject to the same Guideline.

The task presented to the AER and TNSPs is significant and will require extensive consultation and review. This must be followed by modifications to the current TNSP pricing methodologies to facilitate introduction of the inter-regional charging regime.

Queensland specific considerations

Powerlink commences its pricing process in December of each year, with final prices required to be released to DNSPs in mid-March of the following year under connection and access agreements.

Grid Australia notes that the draft Rule specifies that:

- the AER will be required to amend the Pricing Methodology Guidelines to give effect to the inter-regional transmission charging provisions by 26 August 2011;
- Powerlink is required to submit its proposed updated Pricing Methodology by 28 October 2011; and
- the AER's final decision on the revised Pricing Methodologies put forward by each TSNP is to be published no later than 60 business days later, i.e. end January 2012.

Based on the tight 6-week timeframe proposed in the draft Rule (between end January 2012 and mid-March 2012) and the necessary pricing preparations that must be undertaken to establish prices for the forthcoming year under the existing arrangements, Powerlink will not be able to complete its pricing process based upon the updated Pricing Methodology. Consequently, from a practical perspective, Powerlink will not be able to implement the updated methodology which incorporates the inter-regional transmission charging amendments until the following year (i.e. 2013/14 instead of the AEMC's proposed 2012/13).

Grid Australia proposes a universal commencement date for implementation of the Rule change of 1 July 2013, achieving a consistent approach across the NEM.

Impact of Powerlink transitional provisions

Under the Rules (11.6.12 Powerlink transitional provisions) Powerlink remains subject to the old Chapter 6 pricing arrangements for the current transitional regulatory period (1 July 2007 to 30 June 2012). That is, Powerlink is not required to have an approved Pricing Methodology under Chapter 6A of the Rules in place until its next regulatory period (1 July 2012 to 30 June 2017) , which would require submission of Powerlink's proposed Pricing Methodology in May 2011 as part of its Revenue Proposal.

The draft Rule requires Powerlink to submit its proposed updated Pricing Methodology by 28 October 2011, and the AER to publish a final decision on the revised methodology no later than 60 business days later, i.e. end January 2012.

Under the current Rules, the AER is required to consider Powerlink's proposed Pricing Methodology as part of Powerlink's revenue determination. However, as the draft rule allows for Powerlink's proposed Pricing Methodology to be submitted after the Revenue Proposal in a timeframe consistent with other TNSPs, Grid Australia considers it would be appropriate that the AER be exempted from producing a determination or final decision on Powerlink's Pricing Methodology as part of Powerlink's upcoming Revenue Determination process should this be required.

3.4 The methodology for the redistribution of SRA proceeds

Grid Australia notes that the wording of draft Rule 6A.23.3(ca)(2)(i)(B) does not appear consistent with the intent expressed by the Commission in section 5.4.5 of the draft Rule determination.

The draft Rule specifies that the locational component is simply adjusted for SRA proceeds while the draft Rule determination suggests that the SRA proceeds would be redistributed to customers in a manner consistent with the current Rule namely on the basis of their estimated proportionate use of the interconnector assets within their region via CRNP.

As noted in our previous submission we believe the draft Rule provision as written can be readily implemented. We are, however, unaware of a proven methodology which would allow for the redistribution of the SRA proceeds to customers within the region via the CRNP which is suggested in the draft Rule determination.

It is therefore suggested that the intent of this Rule should be clarified in the Final Determination. Grid Australia proposes that the methodology for the redistribution of SRA proceeds be required to be addressed in TNSP pricing methodologies.

3.5 Aspects of the unders and overs mechanism for inter-temporal adjustments

Under the current pricing provisions of chapter 6A adjustments for under and over recovery of the MAR is via the non-locational component with the amount to be adjusted at an interest rate approved by the AER[2].

[2] Definitions of 'over-recovery amount' and 'under-recovery amount' from Chapter 10 of the Rules.

The draft Rule proposes significant changes to the methodology for dealing with unders and overs in order to quarantine those arising from customer payments from those arising from load export charges. It appears that the unders and overs arising from customer charges will continue to be adjusted at an interest approved by the AER while those arising from export charges will be grossed up by WACC.

This creates a clear inconsistency between the two components. More generally, Grid Australia believes that the level of prescription in the draft Rule in this area is excessive and that aspects of this provision would be better dealt with in the pricing methodology guidelines and the pricing methodologies.

For consistency, the interest rate for grossing up the unders and overs arising from the load export charge should not be specified in the Rules but should be in aligned with the interest rate specified currently for over and under recovery of the MAR.

Draft National Electricity Amendment (Inter-Regional Transmission Charging) Rule 2010

Drafting Comments

1. **Clause 6A.1.1(h)**

1.1 The terms 'inter-regional' and 'transmission services' should be italicised if the AEMC is intending to refer to these terms as defined in Chapter 10 of the *Rules*.

2. **Clause 6A.22.1(c)**

2.1 Is the reference to 'that *regulatory year*' in paragraph (c) intended to be a reference to the *regulatory year* to which the *maximum allowed revenue* relates or the *regulatory year* prior to the *regulatory year* to which the *maximum allowed revenue* relates?

2.2 It appears from clause 6A.23.3 (ca) (2) and (5) that this adjustment is referring to the *regulatory year* to which the *maximum allowed revenue* relates. However, clauses 6A.23.3 (ca) (2) and (5) and clause 6A.29A.4 refer to estimated amounts that will be payable.

2.3 The use of the expression 'paid and received' suggests that the adjustment is based on amounts paid or received during the *regulatory year* preceding the *regulatory year* to which the *maximum allowed revenue* relates.

3. **Clause 6A.23.3(c)**

3.1 The first reference to '*locational component*' and '*non-locational component*' in paragraphs (1) and (2) respectively should not be italicised. This is consistent with the new definitions added to Chapter 10 of the *Rules*.

4. **Clause 6A.23.3(c) & (a)**

4.1 The reference to 'interconnected' in the third line of paragraph (1) should be italicised.

4.2 We believe that paragraph (1) would benefit from being redrafted in the following manner:

> 'The *locational component* is to be allocated to:
>
> (i) *transmission network connection points* of *Transmission Customers* on the basis of the estimated proportionate use of the relevant *transmission system* assets by each of those *Transmission Customers*; and
>
> (ii) *Transmission Network Service Providers* in *interconnected regions* (other than *Market Network Service Providers*[1]) on the basis of the estimated proportionate use of the *transmission system* asset for

[1] It appears that this is what is intended based on the drafting in subsequent clauses.

electricity delivered to that *Transmission Network Service Providers Transmission System*.

The *CRNP Methodology* and *modified CRNP Methodology* represents two permitted means of estimating proportionate use for the purposes of this paragraph (ca).'

4.3 The second reference to *interconnected* in clause 6A.23.3(ca)(3) should be italicised.

4.4 Is it intended that all *Transmission Network Service Providers* (including *Market Network Service Providers*) should be allocated a postage stamp proportion of the *non-locational component*? This is suggested by the current drafting of paragraphs (ca)(3) and (4). In paragraph (3), *Market Network Service Providers* are specifically excluded from the allocation of the *locational component*. These words are not repeated in paragraph (4).

4.5 The reference to 'other' in paragraph (ca)(5)(i)(B) should be deleted because there is only one form of *over-recovery amount* or *under-recovery amount*. The reference to 'other' confuses this concept with the adjustment for overs and unders in accordance with clause 6A.23.3(g).

4.6 Is the reference in paragraph 3(i) to '*transmission network connection points*' of *Transmission Network Service Providers* intended to be a reference to each *transmission network connection point* between a *Transmission Customer* and the relevant *Transmission Network Service Provider's transmission system*?

4.7 The reference to 'interconnected' in paragraph 3(i) should be italicised.

5. **Clause 6A.23.3(g)**

5.1 We understand that the adjustment for over and under recovery is in respect of Year t. However, the relevant adjustment will take place prior to the end of Year t – 1.

5.2 Is it intended that the '…actual amount payable or receivable for a service in Year t – 1' is to be determined by reference to actual receipts or estimated receipts?

5.3 We note that in paragraph (3) the reference to 'distribution determination' rather than '*transmission determination*'.

5.4 In any event the words in clause 6A.23.3(g)(3) should be replaced by the words "grossed up on the basis of the interested rate approved by the AER for any *over-recovery amount* or *under-recovery amount.*"

6. **Clause 6A.23.4**

6.1 The terminology used in paragraph (d) should be consistent with the terminology listed in paragraph (b).

7. Clause 6A.24.1 Pricing methodology generally

7.1 That this clause be amended to require that pricing methodologies to "address the identification and treatment of those taxes and charges which exceed the materiality threshold established in the pricing methodology guideline."

7.2 That proposed clause 6A.24.1(ba) should also be amended to require that the pricing methodology of a *TNSP* that is a *Co-ordinationg Network Service Provider* addresses "the methodology for the redistribution of *settlements residue* auction proceeds."

8. **Clause 6A.24.1(b)**

8.1 The reference in paragraph (1) to '…that provider' is not correct when referring to a *Co-ordinating Transmission Network Service Provider*. Paragraph (1) should be amended to read '… provided by that provider (or providers within that *region*)'.

8.2 The same amendment should be made to paragraph (1)(i).

9. Clause 6A.25 Contents of pricing methodology guidelines

9.1 This clause should be amended to require that the AER pricing methodology guideline specify "a practical threshold to assess the materiality of state based taxes and charges."

10. **Clause 6A.27.4**

10.1 The reference in paragraph (a) should be to the following *regulatory year* or *financial year* given that the prices are fixed for each *regulatory year* and/or *financial year*.

11. **Clause 11.XX.2**

11.1 We note that the AER has previously asserted that clause 33(1) of Schedule 2 to the NEL prevents an amendment to the *Rules* from affecting the previous operation of the *Rules* or anything suffered, done or begun under the *Rules* prior to the relevant amendments.

11.2 In order to avoid uncertainty if the AER takes the same position in relation to the amendments to clauses 6A.24.1(e) and (f), we suggest that this should be expressly dealt with in the Chapter 11 provisions.

12. **Clause 11.XX.5**

12.1 Paragraph (a) should apply '…Despite clauses 6A.24.1(e) and (f)'.

12.2 Given that the *pricing methodology* is applied on an annual basis to fix the prices payable in the preceding *regulatory year*, there exists no reason why Part J of Chapter 6A should require the *pricing methodology* to apply for the duration of the relevant *regulatory control period*. Rather, a *pricing methodology* should apply until it is amended in accordance with the *Rules*.

13. General

13.1 These suggested amendments to not address all issues raised in the Grid Australia submission. Amendments are also required to excise the postage stamped components of the pricing regime from the load export charge.