MCE

Ministerial Council on Energy

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Dear Dr ~~Tamblyn~~ John

Rule change request – Inter-regional Transmission Charging

I refer to the letter of 10 December 2009 from the Hon Martin Ferguson AM MP, Chair of the Ministerial Council on Energy (MCE) detailing the MCE's response to the recommendations of the Australian Energy Market Commission (AEMC) in its Final Report on its *Review of Energy Market Frameworks in Light of Climate Change Policies* (the Report).

In the letter the MCE noted its intention to ask the AEMC to initiate Rule change processes recommended in the Report. The purpose of this letter is to formally request that the AEMC initiate a Rule change process to enable Inter-regional Transmission Charging.

The attached document provides additional information in support of this request.

Should you have any further enquiries, please contact Ms Kristen Palmer, Manager MCE Secretariat, on (02) 6213 6107.

Yours sincerely

Drew Clarke
Chair, MCE Standing Committee of Officials

15 February 2010

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Rule Change Request – Inter-regional Transmission Charging

Implementation of the Rule Change Recommendations of the Review of Energy Market Frameworks in light of Climate Change Policies undertaken by the Australian Energy Market Commission

February 2010

Background and context

In August 2008, the Ministerial Council on Energy (MCE) directed the Australian Energy Market Commission (AEMC) to undertake a review of the existing energy market frameworks to determine if they required amendment to accommodate the planned introduction of the Carbon Pollution Reduction Scheme (CPRS) and expanded Renewable Energy Target (RET). The Terms of Reference asked the AEMC to review both electricity and gas markets across all jurisdictions and to provide detailed advice on the implementation of any changes required to those markets.

The AEMC published its Final Report on the Review of Energy Market Frameworks in light of Climate Change Policies (the Final Report) on 8 October 2009. The Final Report recommended that the existing transmission charging framework be amended to introduce inter-regional transmission charges.

The MCE has endorsed this recommendation and requests that the AEMC progress the Rule change proposal in accordance with the Rule making process under the National Electricity Law (NEL). MCE recognises that in considering the rule change proposal the AEMC must consult widely and may decide to modify the proposed rule to more efficiently or effectively meet the National Electricity Objective.

The following information is provided in support of the Rule change request.

Rule change request

1. Proponent of the Rule change

The Ministerial Council on Energy
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2. Description of the Rule

In its Final Report, the AEMC recommended that a Rule change be made to introduce inter-regional transmission charges. The MCE accepts the rationale put forward by the AEMC as a basis for the proposed Rule which is the subject of this Rule change request. The MCE requests that the AEMC make the proposed Rule change for inter-regional transmission charging.

The Rule change proposes that new inter-regional transmission charging arrangements should be given effect by obliging transmission businesses in each region to levy a new charge – a load export charge – on transmission businesses in adjacent regions. This charge would reflect the flow of electricity from one region to adjacent regions.

The level of the load export charge would reflect the costs incurred in the use of the transmission network in the region to conduct electricity to the adjacent network. The charge should therefore be calculated as if the relevant interconnection with the adjoining network was a load on the boundary of the region.

Key features of the proposed Rule change are:

- Load export charges will be calculated by Co-ordinating Network Service Providers (CNSPs) in each region. Where there is only one Transmission Network Service Provider (TNSP) in a region, that TNSP will be appointed a CNSP. The CNSP in each region will calculate load export charges for flows from its region to each adjoining region.

- Load export charges will be billed to CNSPs in regions into which electricity is imported. As power flows between regions are likely to change direction over the course of a year, CNSPs in adjacent regions shall have the ability to levy load export charges on each other.

- Load export charges will reflect the costs of all (new and existing) assets that the CNSP determines contribute to the transfer capability to export flows to the adjacent region. Therefore, it will comprise both the locational and non-locational components of Transmission Use of System (TUoS) charges, as well as charges for common transmission services.

- The total permitted revenue to be recovered by TNSPs will not change, although the Rule change will alter how revenues are collected.

- The new charging arrangements should begin on 1 July 2011, replacing the existing provisions in the National Electricity Rules[1] for inter-regional transmission charging to occur between adjacent regions subject to negotiation and agreement between the jurisdictional governments of those regions.

Detailed design elements

The Rule change proposes the introduction of the following new arrangements:

- CNSPs are to determine "pre-adjusted" locational TUoS charges to be levied on both CNSPs in adjacent regions and customers within the CNSP's region. The proceeds of inter-regional settlements residue auctions are no longer to be distributed to customers through reductions in locational TUoS charges.

- CNSPs are to determine "pre-adjusted" non-locational TUoS charges to be levied on both CNSPs in adjacent regions and customers within the CNSP's region. Non-locational TUoS charges for within-region customers are then to be "adjusted" to account for the distribution and recovery of: inter- and intra-regional settlements residue; under- and over-recoveries; amounts arising as a result of the constraining of annual changes in TUoS charges; amounts arising as a result of the application of prudent discounts; and amounts associated with the recovery of inter-regional non-locational TUoS charges levied by other CNSPs.

- CNSPs are to determine "pre-adjusted" common services charges to be levied on both CNSPs in adjacent regions and customers within the CNSP's region. Common services charges for within-region customers are then to be "adjusted" to account for amounts associated with the recovery of common services charges levied by other CNSPs.

- CNSPs are to recover inter-regional "pre-adjusted" locational TUoS charges levied by other CNSPs through "adjusted" non-locational TUoS charges applied to within-region customers on a transitional basis. On an enduring basis, such charges should be recovered through "adjusted" locational TUoS charges applied to within-region customers, once CNSPs have implemented changes to their pricing methodologies to allow for the recovery of these charges based on customers' proportionate use of network assets in adjoining regions.

- A transitional provision is proposed to enable the Australian Energy Market Operator (AEMO), in its role as CNSP in Victoria, to amend its pricing methodology during the current regulatory control period in order to adopt a cost allocation process consistent with the derivation of cost-reflective inter-regional locational TUoS charges.

- CNSPs are to provide estimates to other CNSPs before 15 May each year of inter-regional "pre-adjusted" charges to be levied in the following financial year, in order to allow for the incorporation of the recovery of such charges through the "adjusted" charges to be levied on within-region customers published on 15 May.

A draft Rule to give effect to this Rule change request is contained in the Final Report as Appendix H. The MCE notes that the AEMC will conduct further consultation on the proposed Rule in accordance with the standard Rule change process.

[1] National Electricity Rules clause 3.6.5(a)(5).

3. Nature and scope of the issue that is proposed to be addressed

In the Final Report, the AEMC concluded that the introduction of the CPRS and, particularly, the expanded RET has the potential to increase the transmission network investment undertaken to facilitate flows between regions. This is because these climate change policies are likely to lead to changes in flows on the network as they change the economics of generation investment decisions and electricity production.

It is likely that renewable generation will be concentrated in certain regions, given the distribution of renewable fuel sources. This may lead to increased power exports from those regions and increased imports into other regions.

Under the current transmission charging arrangements, customers do not contribute to the costs of transmission assets in other regions that support electricity flows to their region, even if they benefit from those flows. Instead, transmission businesses recover their revenues solely from customers within their own regions.

The lack of a robust inter-regional transmission charging mechanism essentially prevents transmission network charges being seen across region boundaries. This leads to less cost-reflective transmission pricing, in that customers are not exposed to all the costs that they are imposing on the system.

Against this background, positive net inter-regional flows will lead to implicit cross-subsidies between customers in different regions. This is likely to be an increasingly material issue given the greater inter-regional flows anticipated as a result of climate change policies.

The absence of a mechanism to resolve this cross-subsidisation could represent a potential barrier to the co-ordinated planning of transmission investment across different regions, which will become increasingly important as the dispersion of generation across the network changes and the requirement for investment in assets to provide inter-regional transfer capacity increases.

As part of the National Transmission Planner (NTP) Review, the AEMC advised the MCE that the current lack of a systematic inter-regional transmission charging mechanism could impede the development of a more efficient, national transmission network. In response, the MCE requested that the AEMC consider the need to improve the existing inter-regional transmission pricing arrangements in light of climate change policies. The MCE endorses the findings made in the Final Report by the AEMC in this respect.

4. How the proposed Rule will or is likely to contribute to the achievement of the national electricity objective

The Rule making test contained in section 88 of the NEL requires that the AEMC may only make a Rule if it is satisfied that the Rule will or is likely to contribute to the achievement of the National Electricity Objective (NEO). The NEO, as set out in section 7 of the NEL, is as follows:

"The objective of this Law 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."

Increasing the cost-reflectivity of charging

The proposed Rule will have the effect that importing regions will contribute towards the costs of all existing and new assets used by adjacent regions to provide the inter-regional transfer capability required to facilitate the imports of electricity. The recovery of these costs through the transmission charges levied on load customers in importing regions will ensure that such charges are more cost-reflective.

More cost-reflective transmission charges will contribute to the achievement of the NEO by leading to more efficient use of the transmission system by existing and future transmission customers. This will result in more efficient operation of, and investment in, the transmission system, promoting the long term interests of consumers of electricity with respect to the price of supplying electricity.

Ensuring efficient transmission network investment is undertaken

The revised charging arrangements to be introduced by the proposed Rule will remove existing implicit cross-subsidies between consumers in different regions. Such cross-subsidisation could represent a potential barrier to the co-ordinated planning of efficient transmission network investment across different regions.

In that the arrangements proposed in the Rule change request provide for a more efficient cost-allocation mechanism, allowing for transfers between transmission operators and minimising the creation of "winners and losers", they should strengthen the timeliness and efficiency of network investment. This will contribute to the achievement of the NEO through more efficient investment in the transmission system, promoting the long term interests of consumers of electricity with respect to the price of supplying electricity.

5. Expected benefits and costs of the proposed change and the potential impacts of the change on those likely to be affected

Benefits

The benefits of the proposed Rule change will be the resulting more cost-reflective transmission charges and the elimination of implicit cross-subsidies between consumers in different regions.

These will promote the efficient use of, and investment in, the transmission system. In particular, they will remove a potential barrier to the co-ordinated planning of transmission investment across regions, which will become increasingly important as the dispersion of generation across the network and resulting pattern of network flows changes as a result of climate change policies. They will therefore ensure that the long term interests of consumers of electricity are promoted with respect to the price of supplying electricity.

Costs

The implementation costs of the proposed change are not expected to be significant. The introduction of the arrangements proposed in the Rule change request represent a relatively simple and incremental change, requiring only minor amendments to the existing charging arrangements and systems. The MCE considers that the proposed Rule change therefore represents a proportionate and efficient response to address the problems identified.

The MCE also notes that implementing the arrangements proposed in the Rule change request will be relatively more straightforward than the alternative approaches to addressing the identified problem assessed in the Final Report. The MCE would anticipate however, that, in applying the NEO as the Rule making test, the AEMC would fully assess the costs associated with the change.

Potential impacts on parties likely to be affected

The potential impact of the proposed Rule change on load customers is initially not expected to be significant, for most customers.[2] Currently, flows between regions over the duration of a year tend to largely offset each other, and therefore load export charges levied across regions would also tend to be at a low net level.

As net flows between certain regions increase as a result of changed behaviour driven by climate change policies, there will be a change in revenue recovery such that customers in importing regions may pay relatively higher transmission charges than they would have done, absent the change, in order to contribute to the provision of assets in exporting regions that they are utilising. This change in revenue recovery is the

[2] It should be noted that additional specific impacts on certain customers may result from consequential changes to the allocation of settlements residue auction proceeds that are a feature of the proposed change. More information on this issue is contained in Chapter 4 and Appendix H of the Final Report.

purpose of the proposed Rule change, as the overall increase in efficiency will benefit all consumers across all regions.

The proposed Rule change will also impact on TNSPs. However, as noted above, these impacts are not expected to be substantial, with the introduction of the arrangements proposed in the Rule change request representing a relatively simple and incremental change, requiring only minor amendments to the existing charging arrangements and systems.