

Energy Action Group Inc.

Submission and Comments on the AEMC Scoping Paper on Transmission and Pricing Rules Initial Consultation Scoping Paper¹

Preamble

The Energy Action Group is a membership based, not for profit, incorporated association representing the interest of less than 160 MWh consumers across the National Electricity Market.

Transmission (covered by Chapter 6 of the Rules) is one very clear example of the market failing to deliver outcomes relating to the newly legislated market objective:

“The national electricity market objective is to promote efficient investment in, and efficient use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system.”

It is important for the AEMC to recognise that the overwhelming majority of transmission revenue comes from electricity consumers.

EAG has significant concerns that the AEMC, the MCE and the Reliability Panel are in the process of running a number of reviews concurrently. Further, that a number of these reviews interact with each other and that this convoluted process may lead to very poor policy and rule making.

It is EAG’s contention that the AEMC has an extremely busy work plan: that the time frame provided for in Diagram 1³ and the AEMC web site is far too ambitious to carry out this joint review. We have made a series of comments in the second part of the submission to illustrate this point.

There have been a number of attempts to address transmission pricing issues by both the NECA and the ACCC. To date, all the work by these bodies appears to have failed to deliver the desired outcome. It is likely that this review process will do the same if the time frame continues to be unduly compressed. The process runs the risk of following the badly flawed ACCC Regulatory Test consultation process.

One of the implicit objectives of this revenue/pricing review and possible Rule reset should be the minimisation of regulatory uncertainty for the transmission businesses

¹ Funded by a NEM Advocacy Panel Emergency Grant

³ AEMC (2005) Review of the Electricity Transmission Revenue and Pricing Rules, Initial Consultation Scoping Paper. July. p 32.

so that they can continue investing in new and replacement infrastructure with minimal dislocation to their work programs.

Further, in EAG's experience a profound market event will override the outcomes of both the AEMC Transmission Pricing and Revenue review and the Reliability Panel Review (into reliability standards) as the jurisdictions seek to respond to crisis. This point was demonstrated in Queensland over the summer of 2003/2004, causing both the subsequent Somerville Report and the QCA Electricity Distribution Pricing Determination to be ignored.

EAG has further concerns relating to the emphasis of the process on strictly economic outcomes. Electricity is pivotal to the workings of our society with the power industry relying on a highly trained technical skills base to develop the system to its current level of complexity. Prior to market start, the interconnected transmission system was designed for reinforcement i.e. supplementation of energy supply between jurisdictions in times of shortage. The move to the NEM has converted the purpose of the transmission system to carrying energy flows for market trading and in a manner not originally intended. That is not to say that inter-regional energy flows shouldn't occur. However, in this review process the AEMC must accept the needs for a vision for NEM transmission. Further, this vision should incorporate a long term view of market development. In theory, the vision is currently provided by the Annual National Transmission Statement (ANTS).

The recent MCE report to COAG⁵ provides a useful basis to start the transmission review process:

“While transmission accounts for less than 10% of the total cost of delivered electricity inadequate levels of transmission can result in inefficient energy price outcomes.

- *The transmission system fulfils three key roles - it provides a transportation service from generation source to load centre, facilitates competition, and ensures a secure and reliable supply.*
- *There is a central ongoing role for the regulated provision of transmission, with some scope for competitive (market) provision.*
- *Transmission investment decisions should be timely, transparent, predictable and nationally consistent, at the lowest sustainable cost.*
- *The regulatory framework should maximise the economic value of transmission including through the efficient removal of price differences in the operation of the NEM.”*

Currently energy, spinning reserve and standby generation capacity across the NEM are being carried by a heavily loaded transmission system. The review should examine the role of incentive regulation and the ACCC regulatory test. These may be acting as constraints to investment in adequate transmission capacity to meet future projected energy flows.

⁵ MCE Report to COAG 11th December 2003.

⁹ Regional Boundaries Review, REIMS, the various ACCC amendments outlined in the Scoping Paper and the outcomes of the various ACCC electricity transmission revenue determinations.

There have been a series of consultations⁹ that have reviewed the role of transmission in the NEM since before market start. The review of the Electricity Transmission Revenue and Pricing Rules should try to evaluate the lessons learned from these consultations and to outline the various positive and negative outcomes from these projects, Rule (Code) changes and regulatory determinations.

The recent ACCC Transgrid and Energy Australia revenue determination, for instance, provides an instructive case study that should be examined in the Issues Paper. Then and now this ACCC determination raises some serious questions regarding the interpretation of the Electricity Code (since changed to Rules and the Regulatory Test).

There have been three independent evaluations indicating that inter regional price differentials are costing NEM energy consumers between \$ 1.2 and \$1.3 billion per annum¹⁰. The 1st December, 2004 NSW price spike, for example, relating to a transmission constraint drove up the NSW pool price by an average of \$8/MWh for 12 months¹¹. Since market start the majority of transmission augmentations across the NEM have been instigated by reliability concerns. The major exception has been the ill fated Market Network Service Provider experiments of Murraylink and Directlink.

A most important reason for this failure is that transmission assets have long lives while the current market design and changing consumption patterns deliver different and conflicting outcomes. If EAG was to allocate a priority of work, in our view the major cause of failure was and is the inability of the NECA and the ACCC to establish effective pricing principles.

It is reasonably important to ensure that the work stream outlined in Diagram 1 – Review Process¹³ coincides with the other work streams outlined in Chapter 1.8 of the Scoping Paper. If not, market participants and consumers will end up duplicating their efforts with the MCE and the Rule Change process. It is important to ensure that the work program outlined in the Scoping Paper works contiguously with the ongoing MCE work program.

It is worth noting that the Queensland transmission company PowerLink has just started their next revenue reset. What impact will the review process have on their revenue determination? If PowerLink is excluded, what will be the impacts on TransEnd, ElectraNet and the VENCORP/SPI revenue reset?

EAG also has concerns that most of the consultants available to the Australian industry and regulatory environment have limited capacity to introduce new material and innovative solutions to address many of the issues that confront the AEMC in this

¹⁰ Studies by Bardak, Pareto and Port Jackson partners

¹¹ Evidence presented by Delta Generation at the ACCC Transgrid Predetermination Conference, March 2005.

¹³ AEMC (2005) Review of the Electricity Transmission Revenue and Pricing Rules, Initial Consultation Scoping Paper. July. p 32.

ambitious program. The Bardak¹⁴ submission to the Scoping Paper for instance suggests that the Scandinavian market has a more robust set of transmission arrangements. It is clear that some efforts should be made in the Issues Paper to examine different overseas transmission pricing arrangements

Another issue with the potential to significantly affect the review process outcome is the current review by the Reliability Panel review of VoLL and the NEM reliability standards.

The AEMC needs to ensure adequate provision for funding consumer participation in the review process. Given the ongoing problems of consumer representatives being unable to access appropriate and reasonable resources from the NEM Advocacy Panel, the AEMC must ensure the availability of resources to support consumer participation through the 14 month review process.

Lastly, the review process needs to take in account the complex interactions between technical requirements of the system and the legal economic framework underpinning the industry reform process.

Some Brief Comments on issues raised in the Scoping Paper.

Transition Arrangements

- EAG is unaware of any issues that need to be resolved at this time.

Chapter 5 issues

- EAG agrees with the list of issues identified in the Scoping Paper.
- It is clear that the Issues Paper needs to address the impact of the NEMMCo interpretation of the reliability standards and technical standards, the impact of the standards on network investment and the subsequent effects on revenue and pricing outcomes. Perhaps this could be included in the review of Reliability Standards
- The latest iteration of the ACCC Regulatory Test still disadvantages network augmentation because of the assumption that generator and consumer benefits cancel out. In reality, there is a huge asymmetry between generators and consumers: consumers pay to cover all the costs incurred on transmission augmentation while generators are free riders except when constrained off. The Issues Paper needs to open up the deficiencies in the Regulatory Test for debate and resolution.
- The network owners/operators have been working hard to drive efficiencies in the transmission systems by moving to short term ratings to cover peak line loadings. The Issues Paper needs to examine the relationship of a 5 year regulatory cycle and dramatic changes in transmission network loadings. The

¹⁴ Bardak (2005) Submission on the Review of Electricity Revenue and Pricing Rules Initial Consultation Scoping Paper, August

recent ACCC Transmission determination for Transgrid and Energy Australia highlight a part of this issue. The Issues Paper needs to be able to differentiate between the principles and the application of the principles by the AER/ACCC.

Market Network Service Providers

- Only one of three MNSPs remain. This was a bold experiment based on the premise that high inter-regional prices would be sustained well into the future. The history of Murraylink and Directlink shows that the regional price differential all but evaporated after they were commissioned.

Forms of Regulation

- EAG supports the adoption of a relative light handed regulatory regime. However, the AEMC must assist the AER/ACCC in the process of developing standard accounting definitions and standard regulatory accounts for the transmission companies with the provision of penalties for failing to comply with this reporting function.
- The AER will dramatically streamline the ACCC regulatory approach used for the recent TransGrid and Energy Australia Revenue Determinations.
- That the approach be consistent across transmission companies. Once the rules are established at the start of the process they should endure for the remainder of the determination.
- That the form of regulation ensures a stable investment climate for long term assets.

Asset Base and Criteria for Determining Efficient Investment

- EAG supports the issues identified in the Scoping Paper.
- The principle of using a real starting asset base, adding investment and subtracting depreciation should be continued and that easements be determined by their purchases price or the opening RAB price (whichever is the lowest).

Additional Costs

- That the Issues Paper includes an examination of the treatment of additional costs including various government charges and levies.

Incentive Mechanisms

- EAG supports the development of commercial incentives that facilitate the efficient transport of energy across the NEM. The incentive regime should be for the benefit of end-users.
- The incentive regime should recognise the benefits to consumers of a strongly interconnected system.

Matters in the Existing Rules

- Asses the role of the AER and the levels of regulatory discretion that the AER is allowed to exercise in revenue determinations.
- Develop a more detailed set of Rules to the implementation of the Statement of Regulatory Principles to address the issue of asymmetry between consumers and generators (outlined above).

Transmission Pricing Arrangements

- EAG supports the clarification and simplification of the NEM transmission pricing arrangements.
- That the arrangements be based on the guiding principle that regulation of transmission pricing facilitates the ongoing development of the national grid to enhance energy flows across the NEM.

Non-Transmission alternatives & TUoS Rebates

- Provision in the Issues Paper should be made to examine and evaluate non-network alternative investment. TUoS Rebates are one mechanism to increase the level of embedded generation across the NEM. An issue needing some attention when addressing this topic is the impact on system reliability and the ability of the network alternative to affect peak load power requirements

Range of Charges

- These charges have the potential to change new entrant generator behaviour and will influence future transmission development. It is worth noting that almost all consumers don't like surprise charges being imposed on them that they don't understand.

Allocation of Shared Network Charges

- EAG doesn't have a view on this issue but is aware that it is important in determining the siting of new generation capacity across the NEM.

Form of Shared Network Use of System Charges

- Part of NECA's historic problem in this area was the investigation of different pricing methodologies. Transmission assets in the main are long lived and, intuitively, this leads to a LRMC approach with locational pricing providing a seemingly simple answer. Scandinavia provides a useful example of this approach.

Structure of Charges

- EAG is of the belief that the regulatory objective should be for transparency and NEM wide consistency.

Inter-regional TUoS

- EAG believes that the exploration of inter-regional TUoS should be looked at in conjunction with the Statement of Regulatory Principles and ANTS.

Regulatory Discretion

- EAG hopes that the AER can substantially improve on the performance of the ACCC in transmission regulatory determinations. ACCC changed the rules part way through a determination process and delivered determinations late. Once a regulatory review is set in process then changing the rules and delivering reports at the last minute reduces consumer faith in the robustness of the regulatory proceedings. The regulatory rules for a transmission revenue determination should be simple and understandable to all the parties.
- The regulatory determination should be clear, readable, coherent and transparent with reproducible information and results. Unfortunately, the ACCC has failed to meet this objective in the past.

Guiding Discretion

- EAG favours guided discretion to minimise regulatory risk

Regulatory Processes

- The process is enhanced when the regulator has to consider a wide range of intellectually rigorous information and argument. This can only happen if consumers are better resourced to participate in regulatory determinations

Conclusion/Recommendations

It appears to EAG that the AEMC has two options.

The first is to reduce the number and complexity of issues canvassed in the Scoping Paper, for the AEMC to concentrate on the most vexing short term issues relating to certainty of revenue cap regulation and to clarify the role of the AER in relation to the Rules. If the AEMC adopts this approach then it also needs to signal a direction forward to cover the outstanding issues that were not effectively addressed in the Issues Paper and the report leading to the rule changes and related determinations.

The second option is to widen the inquiry, to slow the process down and to explore the issues in greater depth. EAG recommends this option given both the importance and complexity of issues under consideration in the review process and to optimise the opportunity for stakeholder, including consumer, participation and input.

25th August, 2005