



Our Reference

Your Reference

15 October 1999

Mr Michael Rawstron  
General Manager  
Regulatory Affairs - Electricity  
ACCC  
PO Box 1199  
DICKSON ACT 2602



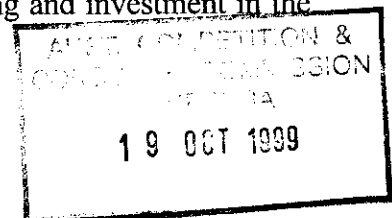
Dear Mr Rawstron,

**Proposed Code changes arising from NECA's Transmission and Distribution Pricing Review**

This submission provides VENCORP's comments on the Proposed Code changes dated 16 August 1999, arising from NECA's Transmission and Distribution Pricing Review ("NECA Review"). The VENCORP Board, which was restructured in July 1999 to include directors from both the gas and electricity industries, is presently further considering the issue of transmission pricing, and would like to reserve the right to make a further and more detailed submission once it has thoroughly worked through the issues.

VENCORP is the Transmission Network Service Provider ("TNSP") for the shared transmission network in Victoria. VENCORP itself owns no transmission assets, but executes its role as a TNSP by procuring "bulk" network services under a long term agreement with the owner of Victorian transmission facilities, GPU PowerNet, and other service providers as appropriate.

The present pricing regime has problems in terms of economic efficiency and equality, however the proposed regime, although overcoming some of these problems, will require much higher levels of resourcing to manage the process and complexities of setting network charges. The proposed regime appears to allow significantly more discretion for TNSPs, who will be required to exercise more judgement in calculating network charges. This is particularly the case for the proposed methodology for allocating the costs for new transmission investment. We understand the rationale for the methodology, however, it may increase the risk of disputes with customers and generators, which would be both time consuming and costly for all concerned. Furthermore, such disputes could potentially lead to delays in commissioning cost effective and economically efficient network augmentations required to maintain system security. Therefore, although the vesting of discretion in TNSPs may initially seem to be efficient, we need to ensure that the proposed pricing methodology does not have the effect of causing inefficiencies in network pricing and investment in the NEM.



The NECA Review has recommended a number of substantial changes to network pricing, compared with the existing requirements in Chapter 6 of the Code. VENCORP believes it would have been helpful for the NECA Code change submission to have included an explanatory memorandum which explained in simple terms the intent of the drafting changes. That there wasn't such a memorandum raises the risk of a lack of mutual understanding of the intent of the changes and widens the scope for later dispute. This is unacceptable for such a significant change of policy in the Code and NECA should produce such a document as soon as possible. This document would greatly assist in understanding the Code changes and clarifying some of the Review's recommendations which appear not to have been carried through by NECA in the Code changes. Furthermore, in an attempt to integrate these changes into the existing structure of the Code, it is our view that Chapter 6 is now difficult to read and interpret. We believe it would be more appropriate to completely rewrite at least part C of Chapter 6, given the substantial changes to this chapter.

The detail of our submission is included as attachment 1 and some specific comments which primarily relate to drafting of the Code changes are also included in the attachment 2 to this submission.

We thank you for the opportunity to make this submission. If you wish to discuss any of these issues further, please feel free to contact Joe Spurio on (03) 9481 9308.

Yours faithfully,



Paul Pemberton  
CHIEF EXECUTIVE OFFICER

## **ATTACHMENT 1**

### **Details of VENCORP Submission**

#### ***New investment***

One of the key conclusions of the NECA review draft report issued in March 1999, was that all the beneficiaries of new investment in the transmission network should contribute to the costs of that investment. Furthermore, it identified the need to develop an appropriate basis for determining these relative benefits, using a process which “should be capable of being applied impartially by NSPs to their investment programs”. The NECA Review’s final report recommends extending the pool modelling which TNSPs are required to carry out to determine the net benefits of an investment, to determine the individual beneficiaries from this analysis.

We believe that there are problems with this approach as, although pool modelling may easily be able to provide reasonably consistent aggregate net benefits, it has the potential to provide dramatically different benefits to individual participants by varying the input assumptions such as bidding strategy, generator variable costs and forced outage rates and new generation developments.

Irrespective of the NECA Review recommendations, the Code changes appear to provide no guidance as to how the beneficiaries should be estimated (refer Schedule 6.8), which then appears to leave the TNSP with total flexibility as to how to achieve this, including the option of not using pool modelling at all. VENCORP does not necessarily have a problem with this flexibility. However, If this is not the intent of the Code changes, then specific reference to extending the pool modelling, and other specific guidelines, need to be included in the Code.

Given the complexities, and to a large extent arbitrariness of attempting to allocate beneficiaries of new investment, consideration should be given to some form of arbitrary allocation of costs of new investment. We believe that there is potential to develop an approach which allocates costs based on categories of benefits such as reduction of unserved energy, or reduction in losses. Such an approach would not be inconsistent with the approach for allocation of ancillary services on a 50/50 basis between customers and generators.

#### ***Pricing for existing networks***

The proposed Code changes require TNSPs to establish a cost range for each relevant connection point for the Customer TUOS charge (refer clause 6.4.3B(c)). VENCORP understands and accepts the requirement for the three methodologies as outlined in schedule 6.4, as one methodology will not necessarily provide appropriate prices for all networks or all locations. However, we do not believe that it is necessary to actually establish a cost range for all connection points as:

- It is recognised that the three methodologies should give similar results in a majority of locations, and therefore, it may only be necessary for a TNSP to calculate three prices at a limited number of locations. With experience, it is envisaged that the most appropriate methodology would be decided upon for a

particular network, or certain connection points, and the requirement for three calculations would be removed; and

- The NECA Review itself stated that “In the event that a particular TNSP considers that one of the methods appropriately reflects the LRMC prices then they would have the ability to set all prices on this basis”

In relation to the Customer TUOS general charge, we believe the clear intent of the NECA Review was that this be a fixed annual charge (ie. \$ per annum) to transmission customers, allocated on a postage stamp basis (refer clauses 7.1 and 8 of Volume 2 of the NECA Review report). This is based on providing cost recovery to TNSPs in a manner which minimises the distortion to the price signals provided. We believe that this is not clear in the Code changes, and in fact clause 6.5.4 appears to provide TNSPs with the discretion to set prices for this component of the charge based on one, or a combination of demand, energy or fixed charges. However, clause 6.4.3C(d)(2) appears to imply that this should be a fixed charge (as distinct from a fixed price). In addition, clause 6.4.3C(b) does not allow for any adjustments for overs or unders in this charge, once again implying it should be a fixed annual charge. The requirement for a fixed annual charge for this component needs to be clarified in the Code.

The Code changes also provide TNSPs with the ability to negotiate discounted network charges with selected customers. We believe that the clear intent of the NECA Review’s recommendations was that this discount be applied only for the Customer TUOS general charge component and that the discount be recovered from other customers through an adjustment in general charge. However, clause 6.5.8(c) of the Code appears to suggest that the Customer TUOS usage charge could also be discounted, and that any discounts be recovered through both the general and usage charges. This needs to be clarified.

VENCorp sees merit in having the ability to discount network charges particularly if existing customers are advantaged as well. This would be the case where a new customer connects to the network as a result of receiving a discount and contributes to sunk costs to some extent. However we wish to make the following comments:

- In order to decide whether a customer should receive a discount or not, a TNSP would presumably be required to make judgements on the customer’s ability to bypass, which includes walking away altogether (for example to another State or energy source). This decision can be very subjective, and may require information disclosure for both parties;
- It is possible that two customers at the same connection point will have different prices, simply due to their ability to negotiate a discount. We question whether this meets the equity objective in the Code. ;
- The logical extension of this recommendation is that those customers with the least ability to negotiate discounts could be left paying an increasing proportion of the sunk costs of the transmission network;
- Will there be a requirement for negotiated network charges and standards of service to be published? If so, some guidelines will be required as to what level of information is published? Our view is that only the standard network charges

should be published in accordance with clause 6.5.7, and that any negotiated charges should be subject to ACCC review in accordance with clause 6.5.8(c); and

- It is our view that to avoid the possibility of large inequities between customers, negotiated network charges should be limited to a very limited number of cases, and the ACCC should publish some guidelines to this effect.

### ***Financial Transfers between TNSPs***

The methodology for calculating financial transfers between TNSPs requires some clarifications in the following areas:

- The model presented appears to require all connections with adjacent TNSPs and interconnectors to be modelled, and costs allocated to those connections where they are a load (ie. export from the region concerned). Does this mean that MNSPs should also be modelled in this way, and therefore result in financial transfers between TNSPs connected by a MNSP? Does the same apply if a regulated link is built between two TNSPs which is owned by a third party? The NECA review suggests the answer is yes to both these questions however the proposed Code changes are not clear on these issues;
- In calculating the applicable customer TUOS usage charge to apply at an interconnection point, a TNSP should presumably use the process outlined in clause 6.4.3B(c) and schedule 6.4, which apply to transmission customers within the TNSP's area. The NECA review suggests this is the case but the proposed Code changes are not clear; and
- Should the fixed annual charges be based on historical actual usage (clause 6.7.4(c)(1)), or based on estimated usage (clause 6.7.4(c)(1))? This level of detail needs to be codified.

Another issue is who would be required to pay the regulated charges for a regulated interconnector connecting two TNSPs, which is owned by a third party. In this situation, would the interconnector owner be required to calculate customer TUOS usage charges for its network, and attempt to recover charges from the connected TNSPs? Or would the interconnector be included in one of the TNSPs areas, therefore having a customer base to charge any residual regulated revenue?

### ***General Comments***

- The Code changes, and especially the additional changes to the 23 July 1999 draft, appear to suggest that MNSPs do not pay any network charges, other than those negotiated for use of system under clause 5.5A(g)(2). This is our understanding of the outcomes of the entrepreneurial interconnector working group, and should be clarified in these Code changes. There are at least two clauses which still leave some doubt:

- Clause 6.7.4(c)(2) could be interpreted as MNSPs being required to pay the customer TUOS usage charge and the common service charge. MNSPs should be deleted from this clause altogether.
- Clause 6.4.4(a) could be interpreted as MNSPs paying common service, as they could be defined as an interconnector.

In addition, clause 6.4.2(b) provides for the allocation of exit services to Network Users which is defined to include MNSPs.

In relation to the pass through of TUOS savings in network charges to embedded generators detailed in clause 5.5(h) & (i), we make the following points:

- The proposal only allows TUOS savings to be passed onto embedded generators, ie. connected to a distribution network. However, under the definition, a generator directly connected to the transmission network (at the same point of connection as a distributor), is unable to receive any TUOS savings, even though the benefits to the shared transmission network are similar. Therefore, we believe that TUOS savings should apply to any generator connected at distribution voltages, rather than to a distribution network;
- Similar to the above, a generator at the same terminal station, but located at EHV voltages receives no TUOS savings, even though its impact on the shared transmission network is the same. This is likely to provide incentives to generators to locate within distribution networks. Nevertheless, we understand that there has to be a boundary drawn somewhere, and therefore we need to ensure that the boundary is clear and that perverse market outcomes do not result; and
- Under the proposal, embedded generators will effectively have access to regulated revenues without the processes required for network augmentations to gain regulated revenues (ie. not subjected to the consultation processes, regulatory tests and cost-effectiveness test). This is not necessarily a bad outcome as long as the TUOS prices are struck correctly. It is clear that at the very least, TUOS savings should only be passed through to the extent that the embedded generation is used within the distribution network (ie. no payment for TUOS savings for energy exported to the transmission network).
- The Code appears silent on how a TUOS price should be set for new connections at a new location on the network, if the connection was not known at the commencement of a Regulatory period. There are various options for dealing with this including:
  - using the price of the electrically nearest location;
  - using the weighted average price of the adjacent locations; or
  - calculating a new LRMC in accordance with one of the three methodologies proposed in schedule 6.4 of the Code.

We believe that a methodology should be codified so that some certainty can be provided.

- The Code describes the relevant network charges that would apply to Transmission Customers and Generators, however it is unclear what network charges would apply to a connection point that can be both a net load and generator (for example where a large embedded generator is connected to the distribution network). This can be further complicated where there are multiple customers at the one connection point. One possible option for dealing with this is to apply TUOS charges as a customer (when a net load), and network charges applicable to generators when a net exporter to the transmission network. The Code requires some clarification in this regard.
- Certain areas in chapter 6 of the Code still appear to interchange between using the term “network owner”, and “Transmission Network Service Provider”. This is a particular issue in Victoria where VENCORP is the TNSP for the shared transmission network and procures bulk transmission services from GPU PowerNet (as the owner of all existing shared transmission network) and others. The Code changes should ensure correct use of these terms.
- There appears also to be similar confusion in the use of “regions” throughout chapter 6. For example, schedule 6.4, clause 9 describes “cost allocation between regions”, which we believe should read “.. between TNSP’s networks”. This is based on the NECA review’s recommendations that financial transfers occur between TNSPs, not regions (as regions could be drawn anywhere in the network in accordance with Chapter 3 of the Code).
- The allowable pricing structures detailed in clause 6.5.4(c) does allow some flexibility in setting network prices, however, it is still restrictive. Prices should be able to be set based on the average of a number of peaks rather than a single summer peak (as is currently the case in Victoria), or based on reactive demand (ie. \$ per MVAR as distinct from \$ per MVA).
- The implementation of the proposed pricing methodologies will lead to prices which could be quite different to present TUOS prices, and therefore different financial impacts on transmission customers and generators. In some cases, these impacts are likely to be substantial. Therefore, there appears to be a need for a transition strategy to the new pricing regime, which will allow both TNSPs and customers to manage financial impacts. The Code appears silent on this issue and requires some guidelines.

## **ATTACHMENT 2**

### **Specific comments which primarily relate to drafting of the Code changes**

- Clause 6.4.3B(b): The reference to the survey period is not correct and probably not required there. The schedule referred to (ie. schedule 6.4) talks about selecting a survey period from the previous financial year, rather than a requirement to use the whole of the previous years data as implied in 6.4.3B(b). Clause 6.4.3C(a): For clarity, after Market Network Service Provider, “or TNSPs” should be included.
- Clause 6.4.3C(b)(1): The reference to clause 6.4.9 is no longer relevant.
- Clause 6.4.3C(d)(1): Non-Registered customers are included as part of the group which are required to pay the Customer TUOS general charge. However, it appears as if they are not required to pay the other components of the network charges (eg. Customer TUOS usage re clause 6.4.3B(b)). This is an anomaly that was not a recommendation of the NECA Review, and appears to be a drafting error that requires rectification.
- Clause 6.4.3C(e): We do not understand why any further reductions in the network charges should apply to Transmission Customers who have negotiated a reduced network charge in accordance with clause 6.5.8(c). We do not believe that this is a recommendation of the NECA Review and should be removed.
- Clause 6.4.6(a): The reference to clause 6.4.3B should be changed to 6.4.3C, as this is the allocation to be undertaken on an annual basis. This would then be consistent with clause 6.5.4(e).
- Clause 6.7.4(b): The reference to clause 6.5.5 should be to clause 6.5.4.
- The diagram on page 6.23 is very useful, especially in showing what charges apply to each participant, ie. transmission customers and generators. This could be improved by including references to relevant clauses in the Code, and including separate boxes for MNSPs and connected TNSPs.
- In order to aid in the understanding of the proposals, an additional diagram could be included which shows the relevant processes to go through in allocating sunk costs and in allocating the costs of new investment, once again with references to various clauses in the Code