

Major Energy Users, Inc

The voice of energy consumers

Transmission Pricing

AEMC Draft Rule

Discussion Forum 30 November 2006

Presented by

Mark Gell Chair MEU and EMRF, and
John Pike Chair ECCSA and Deputy Chair MEU



Major Energy Users Inc

The Voice of energy consumers

The MEU goals for the review

- MEU seeks a transmission system which
 - ❖ Is economically efficient and overall lowest long term cost to consumers
 - ❖ Facilitates a true national electricity market
 - ❖ Grows to meet consumer needs and reduce generator market power (both intra- and inter- regional)
 - ❖ Is secure in the long term (users have invested in the long term too!)
 - ❖ Is reliable
 - ❖ Delivers acceptable quality
- Signalling must be useful to consumers and others, but current and planned signal do not do this
- Consumers want equity, cost reflectivity, certainty and consistency in the prices for providing the service, yet AEMC has allowed TNSPs to have flexibility in decisions which are critical issues for consumers and where TNSPs have little incentive to get them right

The AEMC process

- There is a consistent statement made throughout the draft determination – that “the majority of respondents ...”
- There were 17 respondents to the proposed draft. 8 were from asset owners or beneficiaries, 3 from generators that pay little TNSP revenue, 1 from regulators, 4 from those representing consumer views and 1 from an environmental proponent.
- On the basis of commentary made on the issues the bias towards TNSPs is even more pronounced
- The entire focus was the impact on TNSPs and generators, yet the investments made by consumers are not considered at all
- All consumers pointed to problems and concerns in the proposed Rule

... And yet the AEMC states that the pricing Rules are not contentious

Pricing impacts consumers most, yet they are least considered (1)

- AEMC applied clear signals for Rev Rules, but not Pricing Rules

The AEMC sees that TNSPs need flexibility in pricing approaches because of

- Innovation in metering yet TNSPs have the most sophisticated meters now
- Regional differences – what are these that impact pricing when consumers want consistency and certainty
- It provides incentives for TNSP investment – at best this is modest but outweighed by consumer needs for consistency and certainty for consumer investment

Pricing impacts consumers most, yet they are least considered (2)

- The changes to the Rules will flow to distribution and to gas assets
- Pricing provides signals for investment by consumers. They marginally impact TNSP investment, and under the AEMC changes, generators not at all
- There are weak incentives for TNSPs to get pricing right
- There are no locational signals in pricing for generation, including embedded generation
- There are no pricing signals for DSR
- There are no pricing signals for inter-regional investment

The allocation of costs

- The AEMC uses Baumol-Willig (costs to lie between avoided costs and stand-alone costs) as the band width for cost reflectivity – this is too wide
- What B-W does not do is recognise that there is a benefit to all by sharing
- If there is any move away from the balance point towards either extreme, then there is a bias to one customer class over another.
- This bias is not in the interests of consumers, yet the issue is not debated at all, but gives the TNSP wide powers to set the cost allocation.
- There is little ability of the AER to verify that this allocation gives results at or near the balance point

Pricing Issues (1)

- Allocation should be decided on the basis showing the extent of the usage – this can only be at the time of peak usage. To allocate costs over any other time, is not efficient or cost reflective, yet the AEMC gives this responsibility to the TNSPs
- The AEMC advises that it supports incentive based regulation, yet there are no network incentives to consumers who load shed at peak usage times
- Embedded generation gets a watered down incentive, if any, dependent on the TNSP pricing approach used
- The argument used by the AEMC not to stipulate any pricing structures is that new metering might create a new approach yet TNSPs already use very accurate metering!
- Where is the consumer benefit in this?



Pricing Issues (2)

- The AEMC wants a principles based approach rather than a deterministic one as this will incentivise TNSP investment (how?)
- This gives power to the TNSPs who do not have the responsibility to address the long term interests of consumers, but do have to serve their shareholders
- Thus there is an incentive on TNSPs to maximise revenue (even by over-recovery) as this is a shareholder cash benefit
- Why give the TNSPs the flexibility denied to consumers?
- Why allow there to be variation between TNSP regions? (eg between \$/MW and \$/MWh, CRNP vs modified CRNP, days for cost allocation)
- Why allow there to be different outcomes between regions which are supposed to be common under the NEM.



Pricing Issues (3)

- DNSPs distort the signals and there is no attempt to rectify this
- Despite the flexibility, TNSP must still price entry/exit as \$/day, general and comm. serves on postage stamp on \$/MW and/or \$/MWh, and TUoS on either \$/MW or \$/MWh or combination of these
- Where is the certainty?
- Where is the consistency?
- Where is the cost reflectiveness?
- Where is the equity?
- Where is the clarity?
- Allocation of losses are detailed in the Rules, why not TNSP revenues



Rule principles should be fixed

1. TNSPs should only recover their costs based on demand as it is demand which drives the cost of providing the service
2. The load and generation data used to develop the prices should only be based on the 10-20 system peak demand days, and for the 6-8 hours on those peak days when the peak is exhibited. This provides a strong basis for allocating costs to those that have caused the maximum system demands (and so the costs of providing the service).
3. TUoS, general and common service costs should be allocated only on demand, and there should be no ability for TNSPs to recover costs on an energy basis. This reflects the costs incurred for providing the service are only related to the capacity of the network.
4. Entry and exit charges recover all of the costs associated with the substations to which users are connected. Therefore TUoS, general and common service costs should be recovered in proportion to the demand at the point where the entry/exit assets interface with the transmission lines
5. There should be no variation permitted between TNSPs



Major Energy Users Inc

The Voice of energy consumers

Outcomes of these Principles

- Requiring point 1 above will equitably allocate the costs caused by users due to their load pattern when these demands are placed on the network
- Requiring point 2 above will encourage users to reduce their demand at times of network stress reducing the need for future network augmentation to accommodate increased demand
- Requiring point 3 above will equitably allocate costs to users based on their load pattern
- Requiring point 4 above will encourage consumers and generation to co-locate, reducing the need for future network augmentation
- Requiring point 5, allows consumers to make sensible decisions based on consistency between regions

This provides the equity, certainty and consistency required by consumers

Other issues (1)

- The AER is to set guidelines for cost allocations but the AEMC has both stipulated some issues and flexibility on others which will reduce the power of the AER to “redress the balance”.
- There is little ability for AER to assess issues on a holistic basis
- The connection point for G&CS assessments is to be negotiated but between who (TNSP and ??) What drives the TNSP to negotiate? Who determines what the Rule says?
- There is no signal (yet a network benefit) for consumers to reduce demand when the network is overloaded (this usually occurs for a few hours each year) yet this is not incentivised but can be crucial to deferring investment.
- TNSP is incentivised to invest, so why would it set a pricing approach which defers or eliminates its investment strategy?
- The Pricing determination seems to imply that the consumer commercial benefit will be included in the Reg Test, yet the RT draft decision says no



The AEMC Key Driving Principle

To identify causer of the need rather than who benefits

- In following this principle, AEMC makes little reference to the needs of consumers for equity, consistency, clarity and cost reflectivity
- The AEMC has accepted that the causer of the need is consumers. This is very true for without consumers there is no need for transmission or generation.
- But by accepting this broad definition, the approach makes no attempt to allocate costs to beneficiaries who profit from the consumers needs. As a result embedded generation is marginalised and DSR is prevented
- There is no attempt to require prices to ensure there is the most efficient outcome for consumers – a generator can locate essentially where it likes and the consumer pays the electricity transport costs.
- By following this principle, there are unresolved issues created which AEMC throws to the MCE. Using the consumer as the reference point solves some of these problems



Major Energy Users Inc

The Voice of energy consumers

The AEMC approach results in ..

- Incumbent large generators get no locational signals, and new large generators see little either
- New generation connecting to existing lines can be disadvantaged if there is no spare capacity available
- Non firm (eg wind) generation adds significantly to the capacity needs of the network, yet provides about 25% load factor, but consumers pay the cost
- But small, self and embedded generators face negative locational signals, plus pay fuel transport costs
- Direct connected consumers are the only consumers facing locational signals (Consumers embedded in distribution networks get standard tariffs which have no regard for location, only class of usage)
- There is no analysis to identify the consumer impacts in any of the high level allocative assumptions

Pricing Issues (4)

- Shallow connection for generators but deep for consumers forces consumers to locate near generation, but not the reverse
- The AEMC has made no attempt to identify whether this is more efficient than a generator getting locational signals to locate near consumers. In fact the AEMC sees this as “too hard” and so becomes a policy issue for embedded generation
- By addressing the issue from the consumer viewpoint the debate over embedded generators disappears
- Where is the incentive for a demand side response?
- In fact to avoid losses and costs, generators should be near the loads
- There is no signal for generators to locate to relieve congestion, yet consumers are expected to move



Pricing Issues (5)

- Allocation of TUoS to generators has been glossed over
- Incentives for embedded generation (if any) are paid by DNSPs based on the TNSP allocative approach, to the detriment of embedded generators!
- Yet TUoS is all about allocating signals
- Why should consumers be the only ones to respond to signals
- That TNSPs have not allocated TUoS to generators under the existing Rules could have been because in many cases they have a common owner, and it avoided a contentious issue, and consumers will pay anyway
- That TNSPs have not allocated TUoS to other TNSPs under the existing Rules is that it is easier to and less contentious to pass this cost to consumers



Other issues (2)

- **Importing regions still get the IRSR (to be an MCE problem)**
- **Generators get a share of IRSR**
- **Why have provision prudent discounts when under the revenue Rules TNSP investments made are hardly ever lost from the RAB – there is no incentive to negotiate, and no ability to have arbitration!**
- **The Rev Rules state that commercial arbitration should be used for terms and conditions, yet the Pricing Rules say no! – Commercial arbitration should include T&C as well as price**

Overall assessment

The AEMC could have used the pricing Rules to

- ❖ Incentivise generators locating to reduce constraints
- ❖ Incentivise augmentation of interconnections
- ❖ Incentivise adjacent TNSPs to negotiate on interconnections
- ❖ Incentivise DSR
- ❖ Solved the problem of where residue surpluses go (why to the receiving region?)
- ❖ Reduce the power of the TNSP in negotiating
- ❖ Resolve the issue of who pays when an exit is also used as an entry

... but it hasn't, preferring to give TNSPs the flexibility it denies consumers

The MEU conclusions/summary

- **Major Consumers Are Extremely Concerned**
 - Want a public debate with Commissioners in public pre-determination conference.
- **AEMC Proposed Draft Rules :-**
 - Are unbalanced to the detriment of consumers
 - Lack empirical analysis/evidence
 - Provide too much power to the TNSP which can then eliminate the benefits espoused by the AEMC
 - Do not resolve issues under the current Rules
 - Do not provide incentives to resolve the inter regional issues
 - Ignore consumers concerns

The MEU conclusions/summary continued

The Pricing Rules are

- Are simply conceptual and lacking in understanding of real world dynamics
- Takes away the roles of AER/ACCC by being overly prescriptive (how the costs are to be levied), and then allowing too much flexibility for TNSPs for the regulator to ensure the desired outcomes are achieved

The results of the AEMC decision are likely to be:

- Higher prices
- No pressure on generation to locate where it is needed
- Little improvement in reliability and investment where needed
- Over-investment and gold plating
- Just what the financial engineers want

Consumers have some very serious concerns and all options will be pursued to achieve a more balanced outcome