Major Energy Users Inc.

1 February 2008

Mr. Mike Buckley
General Manager
Network Regulation North Branch
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

By email: aerinquiry@aer.gov.au

Dear Mr. Buckley

ElectraNet Revised Pricing Methodology

We have reviewed the revised ElectraNet Pricing methodology issued in late December 2007. We are of the view that much of it is sound and follows the Chapter 6A Rules and the AER electricity transmission pricing guidelines.

However we do have some concerns with aspects of the proposal put forward by ElectraNet.

1. The clear implication of the Rules is that the prices should attempt to reflect the cost of providing the services. In this regard the AEMC commented in its final determination on pricing (page 25) that:-

> "…it might be more appropriate for transmission prices to seek to approximate the long run marginal cost (LRMC) of providing transmission services. Such prices should reflect the need for, and cost of, transmission augmentation at a particular location in the future. This should work to deter potential consumers (loads) from locating in areas that will require costly augmentation later."

The AEMC goes on to point out that where use of the LRMC might result in a customer electing to cease using the transmission system it considered that a discount up to the value of the SRMC should be available. To this end it

provided for "prudent discounts".

ElectraNet has attempted to ensure that it has allocated its costs appropriately into the various services. In its postage stamp pricing it has then elected to use a mix of allocatory approaches to recover these costs – by using a combination of demand and energy. The AER in its determination on transmission guidelines has noted that this is an acceptable approach as it states (page 20) that the pricing should be:-

> "…such that a transmission customer with a load factor in relation to a connection point equal to the median load factor for all connection points within the region is indifferent to the use of either the contract capacity or the historical energy price. The lower of the two prices is to apply to the connection point."

The MEU points out that this approach is contrary to the concept that the pricing must reflect LRMC as determined by AEMC, as it clearly allows a customer to select the lower cost to it from a price based on energy or demand. As the LRMC is essentially derived from the demand placed on the system (and not the energy transported) then the AER is incorrect in allowing a TNSP to set prices based on the lower of two essentially competing bases for cost allocation and recovery.

2. The Rules require costs to be allocated to one of five services – entry, exit, TUoS locational, TUoS non-locational and common. The AEMC recognised that it is possible that some services might provide for more than one service. This particularly applies in the case where entry and exit assets are shared and the AEMC notes this on page 37 of its final determination where it states:-

> "…the Commission believes that where an asset provides multiple services, individual transmission customers should only be charged in respect of the *incremental* costs of providing the service over and above the cost of providing prescribed TUoS or common services."

This means that where an asset provides more than one service, the TNSP must provide a mechanism where the costs are allocated between the individual transmission customers involved.

ElectraNet has advised that it has accommodated this requirement (page 20) by allocating:-

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> "…the substation local costs in accordance with the provisions of clause 6A.23.2(d) of *the Rules* having regard to the stand alone costs associated with the provision of *prescribed TUOS services* and *prescribed common transmission services* with the remainder being allocated to *prescribed entry and prescribed exit services*."

This approach is **incorrect** as the Rules require the costs to be allocated to the individual customers affected (ie shared by the individuals affected), and not for the costs to be allocated across all customers.

ElectraNet must provide an explanation as to how it will allocate costs for those assets which are shared by specific entities.

3. ElectraNet notes that it is constrained to limit movements of the locational TUoS to be no more than +/- 2% of the average movement of locational TUoS.

   What is not clear from the ElectraNet pricing methodology is that this movement is only constrained during a regulatory period, and that movements greater than this can occur at a reset.

4. In its final transmission pricing Rules determination the AEMC made reference to the location of the "connection point" in so far as it relates to the point at which locational TUoS, non-locational TUoS and common services will be allocated. On page 41 of its FD, the AEMC states:-

   > "Therefore, where a connection point is located continues to be a matter for the TNSP and its customers to determine. The Rules do not preclude a transmission customer or customers agreeing with a TNSP on the location of the connection point. In that regard, the Commission considers this to be a matter of detail and administration and is therefore not appropriate to be specified in Rules."

   The point at which these costs are to be assessed is a critical element for the allocation of costs and therefore the application of prices.

   ElectraNet has **not** stated the points in the networks where costs will be calculated and prices determined. The MEU considers that the connection points for this purpose are the points where the allocation of entry and exit assets interface those assets which comprise the shared network and for which the costs for TUoS, non-locational TUoS and common services are developed.

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5. The MEU notes that ElectraNet proposes to use data from the last compete financial year as the basis for its price development. Although this is permitted by the AER guidelines it would appear to be clearly inappropriate when more recent data is available.

   The MEU believes that more accurate pricing would result if the data used was from the most recent 12 month period for which the data can be collected.

6. ElectraNet notes that it does not consider that data applying to the "peak system" days is appropriate and proposes to use all data in a year as the basis for its methodology. The MEU notes that the AER guidelines option 1 allows for this to occur.

   What is of concern to the MEU is that the AEMC in its determination expected that pricing would be assessed when the system is most stressed. Based on this, the AER developed its option 2 which recognises that the most stress is most likely to occur during the hours of 11 am and 7 pm on the days of peak demand on the system.

   The AER guideline would appear to allow the TNSP a unilateral decision to decide on the basis of what methodology will be used, and not allow customers any rights to select the approach they would prefer.

   It is, therefore, inconsistent that a TNSP will allow customers to select the basis for making payment for non-locational and common services on the basis of what is the lower cost, yet not allow the same right for customers to select the basis on which it would pay for TUoS of the options available. In this regard whilst most customers are indifferent to the basis of the allocation some customers might prefer to have their locational TUoS calculated on the basis of demand during the time when the system is most stressed. In fact, allowing this option has the potential to encourage greater use of embedded generation which is a goal of the MCE, and has been a stated goal of AEMC as well.

   The MEU considers that customers should have the right to select the approach to setting locational TUoS charges that allows them to minimise the costs they incur, following the pattern set by allowing customers to set their preferred approach to prices for non-locational TUoS and common services.

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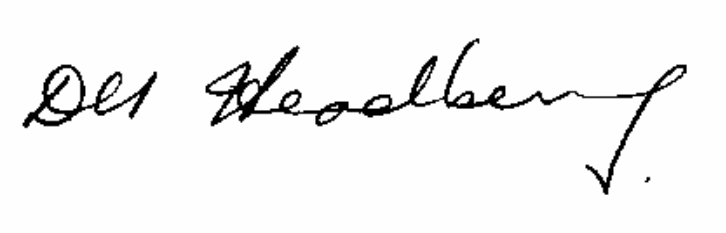
The MEU is available to elaborate on, and discuss, the above comments, as they have important implications for economically efficient pricing of transmission for major users.

Yours sincerely



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