Pricing Methodology Update

TransGrid

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December 2014

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1. Introduction

In the months leading up to the submission of TransGrid's Proposed Pricing Methodology, TransGrid consulted closely with customers, large energy users and consumer representatives. The proposal made at the end of May 2014, addresses the concerns raised in formal submissions, during one on one briefings and through our wider engagement program. As a network service provider, we take seriously our commitment to minimise the charges passed through to customers and energy consumers while also taking into account an equitable spread of costs. The two key elements on feedback we received were a drive for transmission pricing which is more cost reflective and that moves to reduce the postage stamp proportion of transmission use of system costs.

On 27 November 2014, the Australian Energy Regulator (AER) released its Draft Determination on our Revenue Proposal. This included their draft decision on our Pricing Methodology. While the AER recognised our intent to include stakeholder feedback in the development of our proposed methodology, they considered that it did not comply with the relevant rules. This included the pricing principles in the National Electricity Rules (NER) and the requirements set out in the pricing methodology guidelines.

Following this decision, we revised our Pricing Methodology to address the AER's concerns. It should be noted that this has translated into a reduction in the emphasis placed on requests from customers, large energy users and consumer representatives. To ensure our customers and stakeholders are fully informed throughout this process we are initiating another round of conversations prior to the submission of our revised Pricing Methodology in January 2015.

This paper will give you an update on the status of the elements of TransGrid's original Pricing Methodology as listed in the table below.

Table 1 – Proposed change in submitted methodology

Proposed change in submitted methodology	AER Response	TransGrid Response	Revised Proposal Rules Compliance
1. Modifying the way the excess demand charge is calculated (section 12.4.1)	Accepted	Noted	✓
2. For locational TUoS services, switching to a 20 day peak period cost allocation (section 12.4.2)	Further consultation required	Withdrawn	✓
3. The introduction of MVA pricing (section 12.4.3)	Further consultation required	Withdrawn	✓
4. The ability to amend aspects of TransGrid's approved pricing methodology during the regulatory control period (section 12.4.4)	Not accepted	Withdrawn	✓
5. For non–locational TUoS and common transmission services, basing prices on maximum demand and applying a side constraint equal to CPI + 3 per cent (section 12.4.5)	Not accepted	Modified	✓
6. The availability to negotiate a fixed price with its transmission network customers (section 12.4.6)	Not accepted	Withdrawn	✓
7. Implementation of modified CRNP	Not accepted	Modified	✓
8. Interregional —TUOS	New to revised methodology	Proposed	✓

2. Status update on each element of TransGrid's Proposed Pricing Methodology

In this section, we will outline the status of each element of the Pricing Methodology.

2.1 Modifying the way the excess demand charge is calculated

TransGrid originally proposed (section 12.4.1 in TransGrid's Revenue Proposal) to modify the calculation of the excess demand charges to be more cost reflective.

The AER approved the proposed modification of the excess demand charges on the basis that this may lead to better outcomes for customers.

We acknowledge the AER's acceptance of this element, however we will not include this change into the revised pricing methodology as the benefits are overshadowed by the benefits obtained through implementing a yearly maximum demand based postage stamp rate (discussed below).

2.2 For locational TUoS services, switching to a 20 day peak period cost allocation

TransGrid notes that the AER suggested that some further consultation was required surrounding the switch to a 20 day peak period cost allocation.

Our proposed Pricing Methodology (section 12.4.2 in TransGrid's Revenue Proposal) recommended applying the T-PRICE software over the 20 days with the highest peak demand. The T-PRICE software is the industry standard way of applying utilisation pricing.

The AER highlighted that while the time period over which peak demand is assessed is not defined in the NER, the pricing methodology guidelines specify two approaches which can be either: using every day of the year, or 10 peak day method.

Further analysis has shown that while maximum utilisation of transmission elements in NSW can be modelled using a reduced set of system snapshot conditions, it would need significantly more than the 10 days to get an effective outcome. Applying the analysis to the 10 system peak days in 2013/14 reflected max utilisation on only one third of the transmission elements, and even less in 2014/15. Accordingly TransGrid proposes our revised Pricing Methodology is based on using cost reflective network pricing on a 365 day basis.

As a result our revised Pricing Methodology is based on the industry standard, T-PRICE software allocating system costs using cost reflective network pricing on a 365 day basis.

2.3 The introduction of Mega Volt Amps (MVA) pricing

TransGrid proposed (section 12.4.3 in TransGrid's Revenue Proposal) that transmission prices would be levied on the basis of MVA (apparent power) not MW (real power) from 1 July 2017. This was following consultation with customers and other stakeholders.

We note that while the AER suggested further consultation on this matter, we were proposing to transition to this new mechanism from 2017 in order to allow time for appropriate metering to be installed.

The ability to amend aspects of the final Pricing Methodology during the regulatory control period has not been approved (section 12.4.4 in TransGrid's Revenue Proposal) and we are not in a position to have the necessary metering in place by the time this pricing methodology is implemented, therefore we have withdrawn this particular change from our revised Pricing Methodology.

2.4 The ability to amend aspects of TransGrid's approved pricing methodology during the regulatory control period

As discussed previously, TransGrid notes that the AER does not accept this proposed change (section 12.4.4 in TransGrid's Revenue Proposal) on the basis that it does not comply with the requirements under the NER and the pricing methodology guidelines.

In acknowledgement of the AER's decision, we have withdrawn this proposed change.

2.5 For non–locational TUoS and common transmission services, basing prices on maximum demand and applying a side constraint equal to CPI + 3 per cent

The AER believes TransGrid's proposed 3 per cent side constraint (section 12.4.5 in TransGrid's Revenue Proposal) does not comply with the pricing principles in the NER and therefore cannot be accepted.

The AER accepted the proposal to use maximum demand to devise prices for non-locational TUoS and common transmissions services, as by itself it conforms to the pricing methodology guidelines under the second permissible pricing structure for non-locational TUOS and common transmission services. However they did not accept the side constraint change. TransGrid has investigated retaining this part of the proposed change in the revised Pricing Methodology (without the side constraint equal to CPI + 3 per cent). Figure 1 below shows the percentage change in total annual charge for each of TransGrid's connection points.

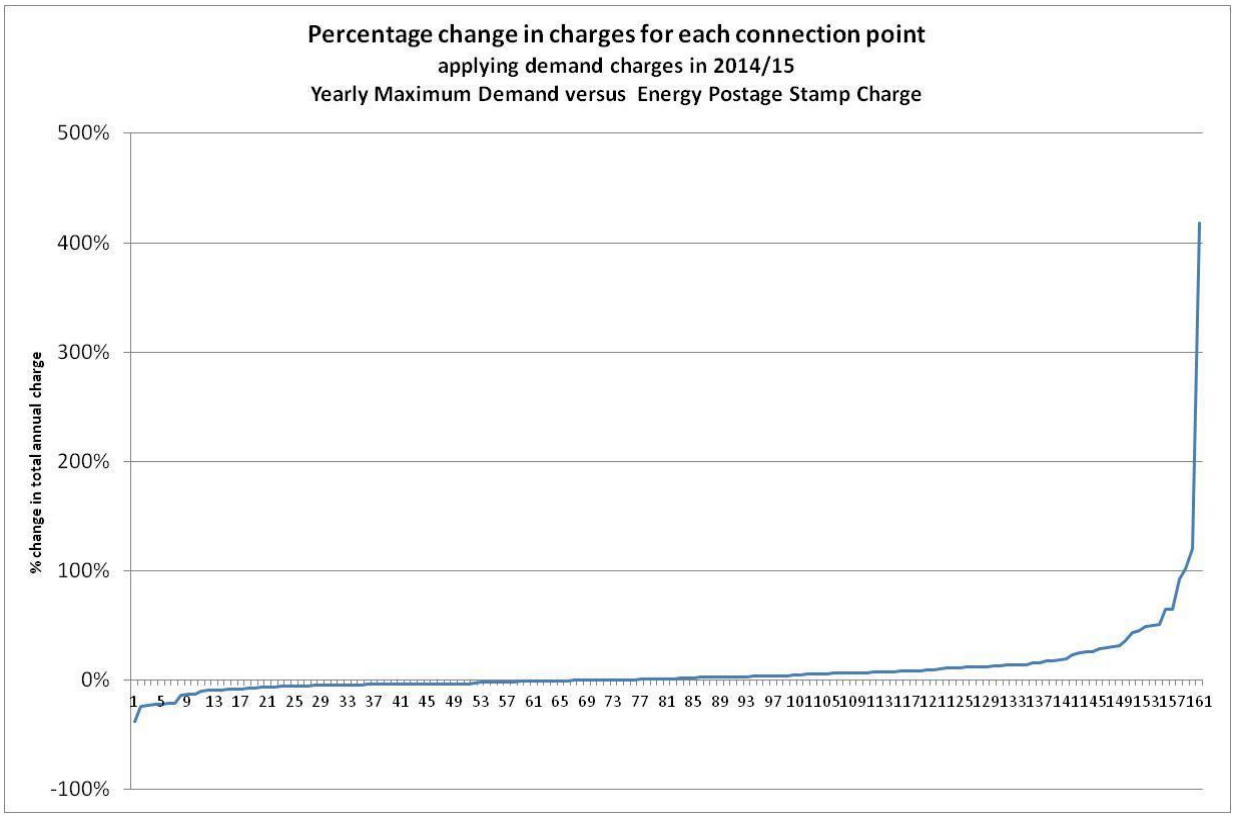

Figure 1: Percentage change for each connection point applying demand based charges

There are four customer connection points that have a change in the annual charge greater than 50% and less than 100%, and three customer connection points that have a change in the annual charge greater than 100%. The connection points experiencing changes in the total annual postage stamp charge greater than 100% are predominately the result of loads with low load factors due to in embedded generation. At these locations should the DNSP pass through the maximum demand postage stamp charge as part of the distribution pricing tariff, then the load customers will pay less than the annual charge payable under the existing pricing methodology as the yearly maximum demand postage stamp rate is less than the amount paid using an energy-based postage stamp rate. For customer connection points having a change in the total annual charge between 50% and 100%, distribution pricing mechanisms can be used to moderate the impact of these initial price changes over time. TransGrid's initial proposal for the 3 per cent side constraint was intended to provide a transition to demand based prices and therefore reduce the impact of this type of price shock, but the AER concluded that it does not comply with the pricing principles in the NER and therefore cannot be accepted.

Based on the AER's decision, 3 per cent plus CPI side constraint is withdrawn, however following subsequent discussions with some large industrial customers and through further analysis, we still believe it would be in the best interests for NSW electricity consumers and customers to maintain a postage stamp charge based on yearly maximum demand in our revised Pricing Methodology.

Our revised Pricing Methodology will retain the first permissible pricing structure, that is 2.3 (b)(2) of the pricing methodology guidelines where permissible postage stamp pricing for either the non-locational component of prescribed TUoS services or prescribed common transmission services must be based on maximum demand.

2.6 The availability to negotiate a fixed price with transmission network customers

Based on feedback with stakeholders, TransGrid proposed to have the availability to negotiate a fixed price with customers (section 12.4.6 in TransGrid's Revenue Proposal).

The AER concluded that the NER does not allow for transmission businesses to negotiate the price of prescribed transmission services with customers. Also stating that these types of arrangements are inconsistent with the prescribed cost allocation and pricing structure requirements in the NER.

We have therefore withdrawn this proposed change from our revised Pricing Methodology.

2.7 Implementation of modified cost reflective network pricing

TransGrid's original Pricing Methodology sought flexibility to start the 2015-19 regulatory period using the standard cost reflective network prices approach to calculate locational prices followed by an application of the modified cost reflective network pricing approach during the period. This proposal was based on analysis demonstrating that it provided a better cost reflective network pricing signal to customers.

TransGrid notes that the AER did not approve this proposal on the basis that the approved pricing methodology must apply for the duration of the regulatory control period and cannot be changed inter-period by a TNSP. The AER's only objection is that TransGrid must nominate which CRNP methodology is to apply for the regulatory period.

Hence, the revised proposed Pricing Methodology will explicitly state that a modified cost reflective network pricing approach will be used.

TransGrid's further modelling surrounding the application of the modified cost reflective network pricing approach with the results of the analysis concluding that modified cost reflective network pricing will:

- Not significantly alter the revenue collection from different revenue categories (i.e. non-location, exit, locational, common service). Figure 2 below demonstrates the revenue collection from different revenue categories.

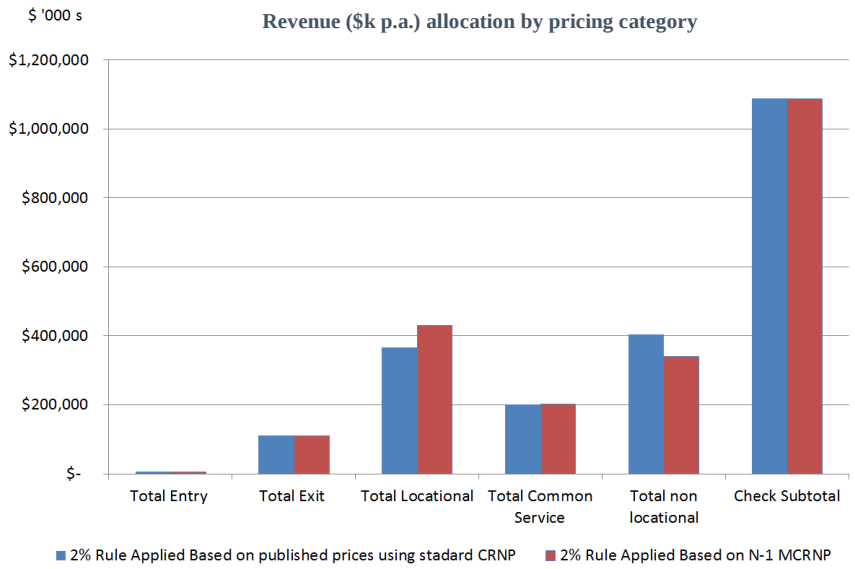

Figure 2: Revenue based on asset class categories

- Leave more than 80% of customer connection points with a change in total annual charge less than 10% from their current charge. Figure 3 below shows the percentage change in total annual charge for each of TransGrid's connection points

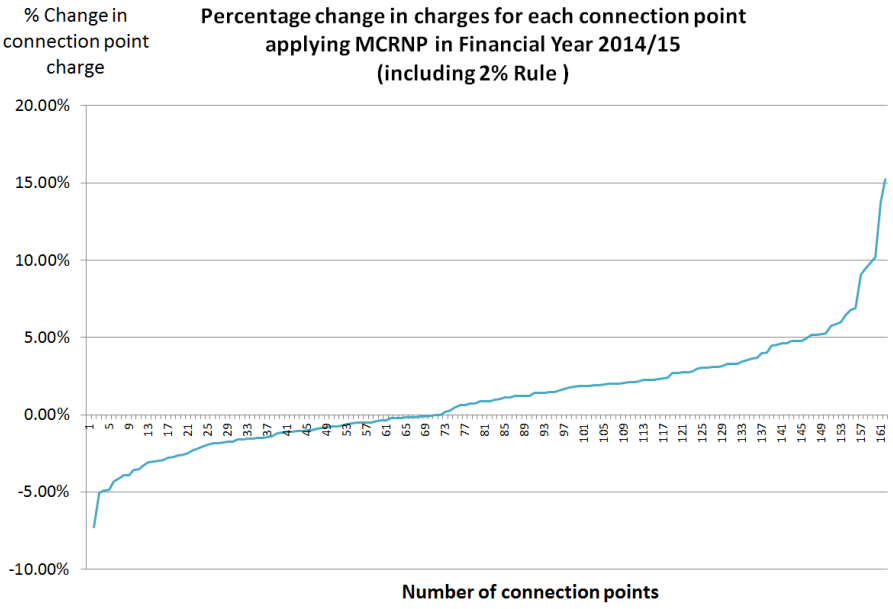

Figure 3: Percentage change in total annual charge for each of TransGrid's connection points

- Provide a strong price signal to those connection point locations connected via highly utilised network areas

As a result of this analysis, we propose to implement the modified cost reflective network pricing for the application of the locational component of TUoS in accordance with the pricing methodology guidelines under the NER.

The combined effect of modified CRNP and adopting a yearly maximum demand postage stamp charge is shown in Figure 4.

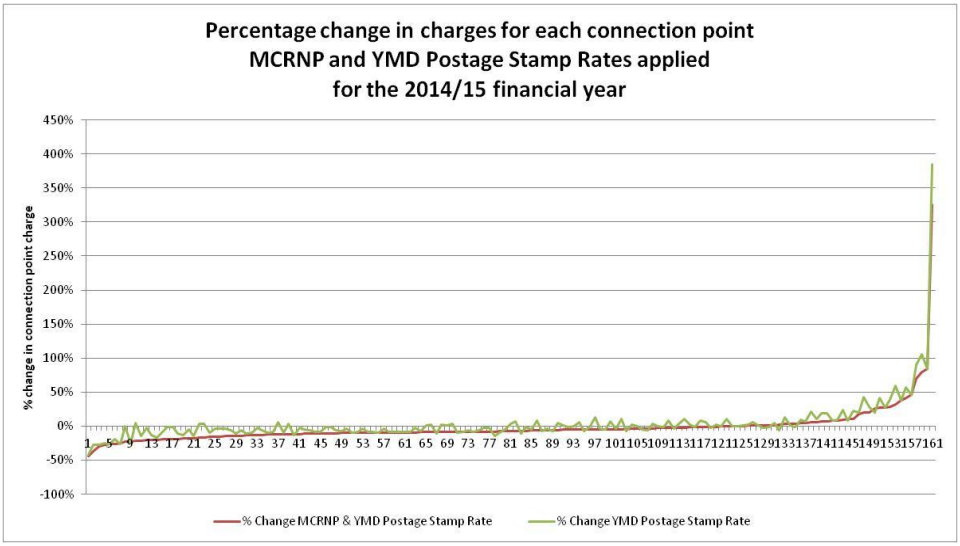

Figure 4: Percentage change in total annual charge for each of TransGrid's connection points for combined MCRNP and yearly MD postage stamp charges.

2.8 Interregional TUoS

This is a new requirement under the rules where TransGrid, as the appointed co-ordinating Network Service Provider referred to in the Rules, needs to calculate the annual aggregate revenue requirement for the NSW region and modified load export charge payable to the NSW region by each interconnected region.

We are required to submit a revised Pricing Methodology, specifically for this by 27 February 2015, which is the date published in the AER's Final Determination for IR TUOS.

Due to the timing of this new requirement, we have accommodated this change by submitting the relevant approach as an attachment to this current proposed Pricing Methodology.