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Ms Elisabeth Ross
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

61 Mary Street
Brisbane QLD 4000
PO Box 15107
City East QLD 4002
Phone 07 3228 8222
Fax 07 3228 8118
Website www.ergon.com.au

Email: www.aemc.gov.au

Dear Ms Ross

ERC0100: Scale Efficient Network Extensions - Options Paper

We refer to the Australian Energy Market Commission's (AEMC) *Options Paper: National Electricity Amendment (Scale Efficient Network Extensions) Rule 2010* (Options Paper) and thank the AEMC for the opportunity to provide a submission.

In addition to providing comment on each of the five possible Scale Efficient Network Extension (SENE) options proposed in the Options Paper, Ergon Energy has provided general comment for consideration by the AEMC in its examination of the benefits and characteristics of a SENE framework.

Should you require additional information or wish to discuss any aspect of this submission, please do not hesitate to contact me.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Carmel Price'.

Carmel Price
Group Manager Regulatory Affairs

Telephone: (07) 4121 9545
Email: carmel.price@ergon.com.au

**Ergon Energy Corporation Limited
and
Ergon Energy Queensland Pty Ltd**

**National Electricity Amendment (Scale Efficient
Network Extensions) Rule 2010 – Options
Paper**

Australian Energy Market Commission

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Options Paper

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This submission, which is available for publication, is made by:

Ergon Energy Corporation Limited and Ergon Energy Queensland Pty Ltd
PO Box 15107
City East
BRISBANE QLD 4002

Enquiries or further communications should be directed to:

Carmel Price
Group Manager Regulatory Affairs
Ergon Energy Corporation Limited
Email: carmel.price@ergon.com.au
Ph: (07) 4121 9545
Mobile: 0408 702 814
Fax: (07) 4123 1124



1 INTRODUCTION

Ergon Energy Corporation Ltd (EECL) and Ergon Energy Queensland Pty Ltd (EEQ) welcome the opportunity to provide comment to the Australian Energy Market Commission's (AEMC) *National Electricity Amendment (Scale Efficient Network Extensions) Rule 2010 - Options Paper* (Options Paper).

This submission is provided by:

- EECL, in its capacity as a Distribution Network Service Provider (DNSP) in Queensland; and
- EEQ, in its capacity as a non-competing area retail entity in Queensland.

In this submission, EECL and EEQ are collectively referred to as 'Ergon Energy'.

Ergon Energy is available to discuss this submission or provide further detail regarding the issues raised, should the AEMC require.

2 GENERAL COMMENTS

Ergon Energy recognises the considerable work undertaken by the AEMC and other parties to date to develop the concept of Scale Efficient Network Extensions (SENEs) but considers that further analysis is required to ensure that the cost allocation and charging frameworks for SENEs are not overly complex to administer and do not result in consumers bearing a disproportionate level of risk (e.g. as a consequence of asset stranding).

DNSP-Specific Issues

The Options Paper (at page 18) notes that the AEMC will have regard to the issues that are unique to DNSPs (including those raised in response to the AEMC's initial SENE Consultation Paper), when developing draft changes to the National Electricity Rules (Rules). Ergon Energy contends that the importance of some issues necessitates a series of further interactions between the AEMC and affected parties to ensure that participant concerns are adequately addressed.

For example, in Ergon Energy's May 2010 submission to the AEMC's initial SENE consultation, significant concerns were expressed regarding the lack of clarity as to:

- How the AEMC envisages that a new Negotiated Service will be introduced mid-period without re-opening a Distribution Determination;
- Whether revenue related to Negotiated Services is able to be recovered from a DNSP's Standard Control Service customers and how this would comply with the pricing principles under the clause 6.18.5 of the Rules;
- How SENE connection charges would interact with a DNSP's existing arrangements (e.g. Alternative Control Services Design and Construction Services for large customer connections), in circumstances where a SENE connects to the distribution network; and

- How the calculation and administration of compensation under the proposed access provisions operate given their apparent complexity and that a Network Service Provider (NSP) may not have the requisite skills and data to manage the compensation arrangements effectively.

Also, presumably where the costs of additional capacity are to be recovered from customers, there will be additional transmission charges levied on DNSPs to 'pass through' and recover. The current Rule change proposal: *National Electricity Amendment (DNSP Recovery of Transmission-related charges) Rule 2010* proposes to broaden the definition of Transmission Use of System (TUOS) charges to ensure all transmission related charges are able to be passed through to customers by DNSPs. If additional SENE transmission related charges are not captured under these amended definitions, there is a material risk that the additional SENE charges would have to be absorbed by DNSPs.

Ergon Energy considers that the Draft Rule be delayed until such time as these issues are satisfactorily analysed and resolved.

Cost Allocation

The Options Paper discusses three approaches to cost allocation which are reflected in each of the five SENE options. These being, the classification of SENE services as:

1. Negotiated services;
2. a combination of Prescribed and Negotiated transmission services; and
3. a new type of Prescribed transmission service.

While the first and second cost allocation approaches may in theory meet the intent of the proposed Rule, both appear complex and are likely to be challenging to implement given the expected need to substantially modify the Rules and establish new mechanisms to calculate and recover costs and rebates to customers and generators (as applicable).

The third approach, on face value, appears easier to integrate into existing pricing frameworks as it allows charges to be levied on generators and costs to be recovered from customers, as per the status quo.

Consistency with the National Electricity Objective

Ergon Energy agrees with the initial SENE Consultation Paper's view that it would be difficult to distinguish SENE from the shared network. A SENE should not be treated differently from the remainder of the network, unless it clearly promotes the National Electricity Objective (NEO) and there is demonstration of a net market benefit in doing so. For example, the scale economies arising from the construction of a SENE may contribute to the NEO and would need to be supported by Rule changes that enable the connection requirements of several generators to be considered simultaneously.

However, the five possible SENE options are unlikely - without modification - to contribute to the NEO. The proposed Rule goes further than is necessary by utilising generation forecasts to drive the need for, and form of, the SENE rather than relying on explicit commitments from generation proponents. In particular, the proposed options imply that the AEMC and the NSPs do not expect subsequent generators (after the first generation proponent) to provide explicit commitments and are suggesting mechanisms to ensure that SENEs are built regardless.

Ergon Energy believes that the risks associated with forecasting generation developments should be acknowledged, including with respect to their size and timing. The NEO will not be satisfied if forecast generation does not transpire, particularly where the costs of developing a SENE are borne by customers. SENEs should therefore only be developed when a proponent or proponents can be found that are willing to financially commit to a material share of the development.

3 SPECIFIC COMMENTS ON POSSIBLE SENE OPTIONS

Ergon Energy's comments in relation to each of the possible SENE options are as follows:

Options 1 and 2

Ergon Energy believes that the proposed cost threshold trigger at which a SENE is built (once 25 per cent of the capital costs of the investment are underwritten by firm connection agreements with generators) places a disproportionate level of risk and cost on consumers and is therefore too low.

Not only is a higher threshold trigger more appropriate because of the risk of asset stranding risk, but also because a SENE built with a high unallocated capacity may not be the most optimal use of financial (and physical) resources given the time value of money and the fact that it could be many years, if at all, that the SENE becomes fully utilised.

Option 2 is preferred over Option 1 as it appears to be more simplistic with the removal of the proposed compensation arrangements. It also appears to support Ergon Energy's preferred position that an explicit economic test should be applied to SENEs. On face value, the introduction of a cost threshold trigger also appears to be an appropriate measure to further protect customers and strengthen the investment test.

Both Options 1 and 2 propose to introduce Negotiated services. This is likely to require substantial amendments to the Rules and a new cost recovery mechanism to implement (i.e. as it does not appear that costs and rebates could be recovered from, or returned to customers through the typical TUOS charges levied on customers by DNSPs under existing arrangements).

Options 3 and 4

Ergon Energy considers that these options are preferable to Options 1 and 2 as the first connecting generator would be required to pay its stand alone costs which would result in the generator being no worse off than if the SENE did not exist.

Under Option 3, customers will permanently fund incremental capacity, while the initial generator(s) will be rebated against their stand alone costs as future generators connect to a SENE. Arguably, this option could also result in a disproportionate level of risk being borne by consumers.

Given that customers will permanently fund incremental capacity and any costs of augmentation through the Prescribed transmission component of the charging methodology - the RIT-T will be critical to demonstrate net market benefits.

The rebate arrangements for the initial generator(s)' stand alone costs (i.e. the Negotiated services component) could also become quite complex to manage as future generators connect to a SENE.

Ergon Energy sees greater value in Option 4 compared to Option 3 as it more proportionately balances the level of risk – as customers would not be required to permanently fund the incremental capacity – and the initial generator(s)' and customers' costs would reduce over time as subsequent generators connected to the SENE. Thus, the 'subsidy' to generators would eventually be removed and the costs for generators would be truly reflective.

However, Option 4 could be complex to integrate into the existing frameworks and to manage in practice. Similar to Options 1 and 2, an alternative mechanism outside existing TUOS arrangements would be required to facilitate rebates to customers.

Option 5

Option 5 retains the 'causer pays' principle and may be advantageous in that the RIT-T applies to an entire proposed network extension and therefore effectively assesses whether the building of an entire SENE provides a net market benefit. This approach may be preferable to the RIT-T requirements under Options 3 and 4 (from the consumer's perspective where the RIT-T and 'net market benefits' test only applies to the additional capacity, and not the entire SENE).

Option 5 appears to be the most simplistic from a cost allocation and cost recovery perspective as SENE assets could be included in a NSP's Regulatory Asset Base and costs could be recovered as part of the NSP's revenue requirements and passed through to customers in a manner that is consistent with existing arrangements.

While Ergon Energy still has a number of reservations regarding the net value in a SENE, if a SENE framework was to be implemented, Option 5 is preferred.

Changes which Ergon Energy would support to further improve Option 5 to reduce a disproportionate level of risk and cost being placed on customers are:

- the initial generator(s) should be required to fund a reasonable share of their stand alone costs, as well as the ongoing commensurate / proportional average cost for use of the SENE; and
- subsequent connecting generators should be required to provide an upfront share of their network extension costs as well as the ongoing commensurate and proportional average cost for use of the SENE.

This would place a greater share of the risk and cost where it most appropriately lies - with generators - so that distortions are lessened and generators face a more accurate delivery cost.