



CitiPower Pty
ACN 064 651 056
www.citipower.com.au

Head Office: 40 Market Street Melbourne Victoria
Telephone: (03) 9683 4444 Facsimile: (03) 9683 4499 DX 433 Melbourne
Postal address: Locked Bag 14090 Melbourne Victoria 8001 Australia

Powercor Australia Ltd
ACN 064 651 109
www.powercor.com.au

17 November 2010

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Email: aemc@aemc.gov.au

Dear Sir,

Re: National Electricity Amendment (Scale Efficient Network Extensions) Rule 2010

We refer to the Options Paper issued by the Australian Energy Market Commission (**the Commission**) on 30 September 2010 regarding a proposed rule change to facilitate Scale Efficient Network Extensions (**SENE**) (**the Options Paper**), and the forum held on 20 October 2010 in Adelaide.

Citipower and Powercor (**the Businesses**) appreciate the opportunity to comment on the Options Paper. The Businesses note that the Options Paper is intended to be a high level policy overview of the rule change request, the purpose of which is to raise issues of concern amongst stakeholders with respect to the introduction of a framework to accommodate generation clusters on a network. While the Options Paper focuses on transmission arrangements, the Businesses note the Commission's comments that it is intended that analogous arrangements for distribution will be established once a greater understanding of the issues in transmission is reached.

The Businesses support initiatives to facilitate effective and efficient connection of generation. However, the Businesses raise a number of issues and concerns for the Commission's consideration. Before turning to issues for submission, the Businesses seek to provide the Commission with the context in which connection of generation currently occurs in distribution.

Current arrangements with respect to connection

Victorian regulatory regime

Connection is currently subject to two concurrent regimes, which the applicable regulations depending on the connection applicant.

Connection applicants who are not Registered Participants within the meaning of the *National Electricity Rules* (**the Rules**) typically follow jurisdictional rules established by the

Essential Services Commission (**ESC**). Connection applicants who are Registered Participants are required to comply with Chapter 5 of the Rules. The regulations do not preclude a non-Registered Participant connection application from electing to connect under Chapter 5 of the Rules.

Under the jurisdictional arrangements, a connection request is made under s 7 of the *Electricity Distribution Code* (**the Code**). The procedure is then governed by the distributor's Electricity Distribution Licence (**the Licence**) under which a connection offer must be made detailing the terms of connection and any charges that may apply: cl 11 of the Licence.

Under Chapter 5 of the NER, the distributor is required to prepare an offer to connect after a connection request has been made. Acceptance of the offer will lead to the parties entering into a connection agreement.

Under both regimes, ESC Guideline 15 regulates charges and capital contributions from generators, and these contributions are recovered under the Connection Agreement between the generator and the distributor. Traditionally generators have been required to make lump sum payments for connection with no ongoing use of system charges.

Classification and cost allocation

The purpose of service classification goes directly to the issue of the form of regulation to apply and the way in which costs are to be recovered by the distributor. Where a service is classified as a direct control service, the distributor is permitted to recover these services through DUOS charges. Conversely, where a service is classified as negotiated distribution service, the distributor is only permitted to recover these charges from the individual beneficiary customers.

The AER is responsible for determining the classification of services, and thereby determining how a distributor may recover the cost of services. In determining the classification of the distribution service the AER must have regard to the factors set out in cl 6.2.1(c) of the Rules. These are:

1. The form of regulation factors (as set out in s 2F of the *National Electricity Law* (**NEL**));
2. The form of regulation previously applicable to the relevant service or services and, in particular, any previous classification under the present system of classification or under the previous regulatory system (as the case requires);
3. The desirability of consistency in the form of regulation for similar services (both within and beyond the relevant jurisdiction); and
4. Any other relevant factor.

Currently, service classification is such that:

1. where the Businesses have funded the works, the associated capital expenditure will be included in the RAB, allowing the Businesses to recover the return on, and of, this expenditure through DUOS charges; and
2. where the Businesses receive customer contributions, these amounts are netted off the Businesses' capital expenditure included in the RAB.

Regulatory tests

The Rules require that a regulatory test be applied in relation to new network investments estimated to require a total capitalised expenditure in excess of \$1 million. Proposed new network investments or non-network alternative options may satisfy the test via one of its two limbs – the reliability limb or the market benefits limb.

The reliability limb relates to cl 5.6.5A(b)(2) of the Rules and allows projects on the basis that the project will minimise present value of costs of meeting service standards linked to the technical requirements of schedule 5.1 of the Rules or in applicable regulatory instruments. The market benefits limb relates to cl 5.6.5A(b)(1) of the Rules and allows projects on the basis that the project maximises the net economic benefit to all those who produce, consume and transport electricity in the market.

The Businesses note that a regulatory investment test for distribution (**RIT-D**), which will replace the current regulatory test, is to be introduced in the near term. The new RIT-D will require distributors to explicitly consider the potential for non network solutions, and open up the reporting process to public consultation.

Access

Distributors are obliged to facilitate connection in accordance with the Chapter 5 of the Rules and Victorian Licence obligations. Under clauses 6 and 7 of the Licence, the Businesses have an obligation to offer connection services to embedded generators and customers. Guideline 15 also allows generators to negotiate with distributors regarding access to the network, including compensation arrangements.

Design options for SENE Rule Change

Trigger for considering a SENE

The Businesses note the Commission's proposal to require distributors to publish on their websites credible options for development of AEMO identified SENE zones. These options would need to include locations, capacities and indicative network costs. Further, the Commission will require distributors to advertise for further potential connection enquiries in the area.

The Businesses submit that the process for canvassing and verifying options is technically demanding and would require distributors to ensure that they have sufficient technical resources available for each identified SENE zone. The process would involve assessment of environmental and cultural heritage, landowner and easement concerns, as well as network engineering analysis for each SENE zone. There is no limit to the number of SENE zones which may be identified, and therefore it has not been possible for the Businesses to estimate the capacity to meet the proposal, nor the costs that would potentially be incurred.

Investment test

The Businesses note that an investment test is envisaged for assessment of the costs and benefits of a SENE cluster. The proposal involves costs to be assessed by distributors and private benefits assessed by the first connecting generator. Private benefits accruing to future connecting generators are to be assessed by distributors, however distributors do not need to consider any wider market benefits or conduct an efficiency test. In addition, the Businesses note that a minimum threshold of 25% of the total capacity of the

SENE cluster must be met by commitment from generators in order for the project to go ahead.

The Commission correctly acknowledges that cost estimates will depend critically on forecasts of future generation entry. This requires distributors to assess the profitability of generation entry and the probability of generators connecting to the SENE. While the Businesses note that the forecasts must be reviewed and approved by the Australian Energy Market Operator (**AEMO**), this does not reduce the burden of assessing the profitability and probability of generation entry and producing assumptions that would be acceptable to AEMO and the Australian Energy Regulator (**AER**). The Businesses submit that distribution businesses are not in any position to assess the profitability of generation, and consider that analysis of the potential for generation can only be made on an economic basis, not a financial basis. In addition, should the Commission insist on the Businesses undertaking the role of forecasting the probability of generation entry, the Commission must recognise the cost implications from such a decision and ensure mechanisms are in place for distributors to recover their efficient costs.

With respect to the applicable regulatory test, the Businesses submit that adopting the proposed RIT-D would ensure consistency with the existing framework and avoid introducing further tests to the Rules. However, the Businesses note that timeframes for any applicable regulatory test must be cognisant of the difficulties associated with assessing SENE project options, including any delays by regulatory authorities.

With respect to the minimum threshold proposed by the Commission, the Businesses note the Commission's comments that a higher threshold may decrease the likelihood of asset stranding. The Businesses submit that under no circumstances will a project be considered where cost recovery arrangements are not robust. Therefore, irrespective of the threshold level proposed, the Businesses require arrangements whereby recovery of full efficient costs is certain.

Cost allocation

The Businesses are supportive of a 'causer pays' principle that applies to the current connection regime, whereby generators are required to pay the average costs of their connection to the network in proportion to capacity, and customers would be required to underwrite the risk of forecast generation not materialising. Charges for customers would be set so that distributors recover their efficient costs, including a return on their investments.

The Businesses highlight that cost recovery arrangements are dependent on the way services are classified. The Businesses are strongly supportive of the Commission's intentions that distributors are to recover their efficient costs, with risks being underwritten by the relevant distributor's customer base. However, in many of the options proposed in the Options Paper the concerns with respect to service classification have either been ignored, or the options have intended to introduce new terms into the existing service classification framework creating an overly complex arrangement.

The Commission are advised to exercise caution in defining the service classification, in particular, where the Commission seeks to apply existing terms to a new situation or introduce new terms to the existing framework. The Commission need to be mindful of the fact that, while it may intend to define service classification of the SENE in a particular way, the AER is ultimately the authority determining service classification and therefore cost recovery from a distributor's customer base.

The Businesses are inclined to support a proposal whereby the portion of the SENE utilised by the first connecting generator reflects the average cost charge for the share of the SENE that they use in proportion to their capacity. Customers would be required to pay for any revenue requirement not recovered from generators. The service, as a whole, would be classified as a prescribed transmission service (or standard control service in distribution) and as subsequent generation materialises, the amounts paid by generators are netted off from the RAB in the same way as customer contributions are currently managed by distributors. Service classification would therefore remain unchanged, and customers, on average and over time, would not be expected to face any costs.

The Businesses also require a cost pass through mechanism to accommodate investments not included in a previous distribution determination, particularly where the SENE Rule Change is effected part way through a regulatory control period. While the Businesses note that it is possible for the SENE Rule Change to be accommodated within the existing cost pass through categories, there is no certainty that the AER will allow the pass through, and further, costs which fall below the materiality threshold would not be recoverable. The materiality threshold is of particular significance where a SENE project has not been approved but the Businesses have nonetheless incurred costs in preparing information to meet regulatory tests and AER approval. Therefore the Businesses submit that any cost pass through mechanism should not be subject to a materiality threshold.

Access

The Businesses do not believe a prescriptive regime for access is required as access is sufficiently addressed under the Rules in Chapter 5 and under Victorian jurisdictional arrangements in distributor Licence obligations and ESC Guidelines 14 and 15.

Conclusion

The Businesses are supportive of initiatives to facilitate effective connection to their networks. However, any changes to the existing framework must ensure that adequate and workable cost recovery arrangements are in place in order for the Businesses to recover their efficient costs in accordance with the Revenue and Pricing Principles set out in s 7A of the NEL. The Businesses will support arrangements whereby cost recovery can be assured for:

1. Costs involved in options analysis of SENE identified zones;
2. Costs involved in generating forecasts of future generation and meeting regulatory test requirements; and
3. The SENE project, whether or not generation has materialised.

If you have any questions, please contact me on (03) 9683 4282.

Yours sincerely



Rolf Herrmann
MANAGER REGULATION