



27 January 2012

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South, NSW 1235

Project number: EPR0019

Dear Mr Pierce,

RE: TRANSMISSION FRAMEWORKS REVIEW

CitiPower and Powercor Australia (**the Businesses**) refer to the Australian Energy Market Commission's (**the Commission**) First Interim Report entitled 'Transmission Frameworks Review' (**First Interim Report**) dated 17 November 2011. The First Interim Report follows on from a Directions Paper published by the Commission on 14 April 2011.

The purpose of the Transmission Frameworks Review is to test whether the arrangements for transmission in the market are workably efficient and effective for accommodation of future climate change and energy policies. The Commission will ultimately be recommending transmission frameworks that it considers are most likely to optimise investment and operational decisions across generation and transmission in a manner that minimises the overall long term costs to consumers.

The First Interim Report sets out a series of potential alternatives for development of transmission arrangements in the NEM, including congestion pricing, generator transmission standards, regional optional firm access and locational marginal pricing for generators. The First Interim Report also provides a number of proposals for changing the arrangements relating to generation and load connections to the transmission network.

The Businesses are supportive of the Commission's approach to the Transmission Frameworks Review, and make submissions in relation to two specific areas of concern arising from the First Interim Report.

1. Issues with respect to the planning process

Options for reform

The Commission proposes five options to reform the planning process:

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- Option 1: increase coordination of planning in the National Electricity Market (NEM) by requiring the National Transmission Planner (NTP) to endorse the Annual Planning Reports (APRs) and the Transmission Network Service Providers (TNSPs) to endorse the National Transmission Network Development Plan (NTNDP).
- Option 2: implement a harmonised set of transmission planning arrangements across the jurisdictions including the use of financial incentives to promote efficient investment outcomes. This would mean that the Australian Energy Market Operator (AEMO) would not make investment decisions in Victoria.
- Option 3: extend the arrangements in Victoria to create a single not-for-profit national planner and procurer, whereby AEMO perform all transmission network planning, make all transmission investment decisions, and procure new transmission services.
- Option 4: establish a joint-venture body for existing TNSPs to assume all rights and obligations associated with being a TNSP across the NEM. Physical ownership of network assets will be retained by individual TNSPs.

The Businesses confirm that arrangements in Victoria are such that Distribution Network Service Providers (DNSPs) are responsible for planning augmentations of transmission connection assets that connect their distribution systems to the shared network¹. Victorian DNSPs are also required under to publish annual Joint Transmission Connection Planning Reports².

The Businesses also confirm that AEMO is responsible for planning augmentations of the declared shared network³, and that in deciding whether a proposed augmentation to the declared shared network should proceed, AEMO must undertake a cost benefit analysis⁴.

The Businesses highlight two serious issues arising from the connection planning arrangements in Victoria for the Commission's consideration in assessing the merits of any of the proposed options for reform.

Responsibilities for assessing costs and benefits of projects

The first issue relates to the responsibilities for assessing the costs and benefits of an augmentation to the TNSP's connection assets, which includes by necessity some associated shared network asset works. The Businesses advise that in the process of planning for a specific investment, DNSPs conduct regulatory investment tests on the basis of a least cost assessment. AEMO also conducts a cost benefit analysis under the National Electricity Law (NEL). However, AEMO considers that this cost benefit analysis must involve a full review of the entire connection project, not simply a

¹ Clause 14 of the Distribution Licence.

² Clause 3.4 of the Distribution Code.

³ Section 50C of the National Electricity Law.

⁴ Section 50F of the National Electricity Law.

review of the augmentation specific to the shared network, before they agree to fund the shared network augmentation.

The Businesses contend that AEMO's interpretation of the NEL is incorrect. AEMO's cost benefit analysis under the NEL should be limited to works associated with the shared network, and should be used to inform a single regulatory test conducted and led by the DNSP. From a policy perspective, a single regulatory test would ensure that the optimal overall solution would be identified, thus allowing AEMO to fund the shared network augmentation as a prescribed service. Indeed, this interpretation was endorsed and recommended by the AEMC on 26 November 2009 based on a meeting between the AEMC, AEMO, the Department of Primary Industries (**DPI**) and Victorian DNSPs regarding joint planning issues.

The Businesses support the AEMC's recommendation of a single regulatory test for the following reasons:

- Firstly, the practice of conducting two economic assessments of the same project creates inefficiencies and unnecessary project delays. The test applied by the Businesses ensures prudent identification of cost effective projects, and in any event, the Businesses and the TNSP remain accountable to the AER.
- Secondly, the Businesses consider that all of the economic benefits of the connection project are assessed by the DNSP conducting its own cost benefit analysis. This is particularly the case for DNSP initiated transmission connection related augmentations where the benefits are located on the distribution network of which AEMO is not well positioned to form judgements.
- Finally, the Businesses note that all connection projects developed by Victorian DNSPs are, in any event, coordinated with AEMO planning engineers for years prior to the formal commencement of each project. AEMO planning engineers are involved with scoping the shared transmission works component of the project. The Businesses consider AEMO's participation in the initial planning process as sufficient to inform the Businesses' economic assessments. It unnecessary for AEMO to conduct duplicate cost benefit analyses given the level of involvement in the planning process with the Businesses.

The Businesses acknowledge that a Memorandum of Understanding (**MOU**) between AEMO and Victorian DNSPs is currently in the final stages of review and execution. While this MOU details the governance framework for joint planning activities, the MOU is not legally binding and does not override the obligations under the NEL or the NER. Indeed, the MOU demonstrates the inadequacy of the NER to clearly articulate the roles and responsibilities of joint planning in Victoria. The Businesses seek regulatory clarification or confirmation on this issue.

Classification of services under the NER

The second issue relates to the classification of services under the National Electricity Rules (**NER**). AEMO considers that the cost benefit assessment undertaken under the

NEL determine the classification of services as either prescribed or negotiated. In other words, where a proposed investment does not pass AEMO's assessment, then the services may be classified by AEMO as negotiated transmission services. Conversely, investments that pass AEMO's assessment determine the nature of the assets as prescribed transmission services.

The Businesses contend that AEMO's interpretation of the NER is incorrect. AEMO does not have any role in the classification of services under the NER. The NER is unambiguous in defining prescribed transmission services. Under the NER, connection services provided by a TNSP to a DNSP are deemed as prescribed transmission services. The NER does not provide discretion to AEMO to classify the services in any other way. It therefore follows that any investment required in the shared network to facilitate a load connection would fall within the definition of connection service and would be considered a prescribed transmission service.

The implication of defining the shared component of load connection investments as a prescribed transmission service means that the costs would be determined under the pricing methodology of the NER and the investment would be included in the TNSP's regulatory asset base (**RAB**). The pricing methodology under the NER is transparent and provides a strict governance framework around a TNSP's ability to recover the costs of such investments from a broad customer base. Given that such investments are for the benefit of all customers on the network, the policy intention to deem prescribed transmission services is clear. This view was reiterated by DPI in a meeting with AEMO, AEMC, and Victorian DNSPs on 26 August 2009 regarding joint planning.

The Businesses submit that classification of services is a crucial aspect of any regulatory regime, and highlight the parallel arrangements in distribution in understanding the significance of a regulator's power to classify services. Under rule 6.2 of the NER, the AER determines the classification of services. The AER, as the economic regulator, has the capacity and knowledge to carry out its functions under Chapter 6 of the NER. In contrast, AEMO does not have any such capacity, nor is AEMO empowered to classify services under Chapter 6. It is therefore inappropriate to assume that AEMO have such powers under Chapter 6A where there are no clear, express provisions in the NER to allow AEMO to interfere in matters of economic regulation.

The Businesses acknowledge that the MOU between AEMO and the Victorian DNSPs confirms that the shared transmission assets of a connection project are to deliver prescribed services. However, the Businesses note that the MOU is not legally binding and does not override the obligations under the NEL or the NER. Further, the MOU does not serve to confirm the Businesses' interpretation of the relevant NER provisions, as the MOU is a temporary solution to the current arrangements. The Businesses therefore continue to seek regulatory clarification on this issue.

2. Issues with respect to connection arrangements

The Businesses note the Commission's review of the negotiating framework for connections to the shared network and are supportive of measures that seek to

strengthen and enhance the current negotiation framework. The Businesses note that in Victoria, DNSPs are required to enter into separate connection agreements at the transmission connection interface with:

- the incumbent TNSP describing the interface between the DNSP's network and the transmission connection point; and
- AEMO as the provider of shared transmission services.

The Businesses submit that the way in which contracts between all three parties are negotiated is complex due to the need for all parties to ensure obligations are adequately reflected in all contracts. This complexity gives rise to long delays in negotiation, and there may be times when one contract may already be executed well before a corresponding contract is executed. In these circumstances, there is a risk that a party may be unable to negotiate for a particular provision to reflect terms already agreed upon in the executed contract. While the Businesses acknowledge that all parties are individually responsible for ensuring that risks are appropriately allocated, the bargaining powers of AEMO and the TNSP do not facilitate fairness in negotiations.

For example, AEMO has previously imposed conditions on DNSPs to manage the performance of transmission connection assets. Transmission connection assets are owned by the TNSP and DNSPs have no control over the performance of these assets. While the Businesses have sought to negotiate these obligations into the corresponding agreement with the TNSP, the bargaining power of the TNSP is such that the Businesses are forced to accept the arrangements as proposed by the TNSP in order to ensure projects are delivered in a timely and cost effective manner.

The Businesses therefore seek discussion on alternatives to the Victorian negotiating model to ensure that complicated contractual arrangements can be adequately managed and important connection projects are not subject to long and protracted delays.

3. Closing

The Businesses appreciate the opportunity to make this submission and would welcome the opportunity to discuss any of the matters raised in this submission.

If you have any questions, please contact Vivienne Pham on (03) 9683 2023 or by email at vpham@powercor.com.au.

Yours sincerely,



Brent Cleeve
MANAGER REGULATION