

# **Energy Solutions Australia Pty Ltd**

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RECEIVED

27 MAR 2007

23 March 2007

Dr John Tamblyn,  
Australian Energy Market Commission,  
PO Box H166,  
Australia Square, NSW 1215.

Dear Dr Tamblyn,

## **Re: Obligations of Network Service Providers – Connection Applications**

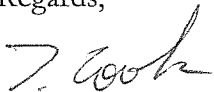
On 15 February 2007 the Australian Energy Market Commission (AEMC) published a Draft Rule Determination on the above matter.

This submission highlights that the basis of the AEMC's decision not to make a draft Rule is not supported by the available evidence and that therefore the AEMC needs to further consider this matter.

As required by the AEMC, copies of this submission have been sent both electronically and via hard copy.

Please do not hesitate to contact me if you require any further clarification on the matters raised.

Regards,



Dr. Tony Cook  
Managing Director

## 1.0 Introduction

On 14 July 2006 Energy Solutions Australia Pty Ltd (Energy Solutions) applied to the Australian Energy Market Commission (AEMC) for the making of a Rule pursuant to Clause 96 of the *National Electricity (South Australia) (New National Electricity Law) Amendment Act 2005*.

The National Electricity Rules (the Rules) provide that some services required by Connection Applicants are contestable and therefore can be provided on a competitive basis. However, the Rules presently provide incumbent Network Service Providers (NSPs) with a competitive advantage. The proposed Rule reduced the competitive advantage enjoyed by the incumbents and therefore facilitated the competitive provision of the contestable services, as intended by the Rules.

In assessing the proposed Rule the AEMC undertook an initial consultation and on 15 February 2007 gave notice that it had decided not to make a draft Rule.

This submission is set out as follows:

- Section 2 identifies the basis of the AEMC's decision not to make a draft Rule;
- Section 3 responds to each of the elements making up the AEMC's decision; and
- Section 4 concludes that the AEMC's decision not to make a draft Rule is not supported by the available evidence and that the AEMC needs to further consider this matter.

## 2.0 The Basis of the AEMC's Decision

The basis of the AEMC's decision not to make a draft Rule is set out in the Draft Rule Determination<sup>1</sup>.

In assessing the proposed Rule the AEMC undertook a two step process viz

1. The AEMC first confirmed that *'the subject matter of the proposed Rule falls within the Commission's Rule making powers as set out in section 34 of the NEL<sup>2</sup>.'*
2. The AEMC then assessed the proposed Rule on the basis of whether it *'promote[d] competition and potentially further[ed] the national electricity market objective,'* which requires that:
  - *'a significant and sustained market failure has been identified that warrants regulatory intervention, eg, an ostensible hindrance to competition;*
  - *the proposed Rule change will deliver benefits by addressing the identified market failure, eg, through the promotion of competition; and*

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<sup>1</sup> AEMC, *Draft Rule Determination, Obligations of Network Service Providers (Connection Applications) (Draft Rule Determination)*, 15 February 2007

<sup>2</sup> Draft Rule Determination, 2007, page 7

- *the potential costs associated with the proposed Rule change do not outweigh the deliverable benefits<sup>3</sup>.*

The AEMC's decision not to make a Rule was based on the proposed Rule's failure to satisfy the second step. In particular, the AEMC's detailed conclusions were that:

- *'there is currently insufficient evidence that the identified informational advantage represents a significant impediment to competition to warrant the imposition of the proposed Rule requirements on network service providers;*
- *there is currently insufficient evidence to support the claim that the proposed Rule will enhance competition for contestable network services;*
- *numerous firms registered on jurisdictional websites are ostensibly ready and able to provide contestable network services, thus competitors clearly exist and appear to be vying with incumbent providers in spite of the identified information advantage;*
- *many of the concerns expressed by the proponent and in submissions about the potential competitive advantage of the incumbent network service provider are removed through clause 5.3.3(b)(3) of the Rules, which requires network service providers to inform connection applicants when a service is contestable, particularly considering that:*
  - *the customers seeking to connect to a network – particularly the transmission network – will very often be large and well-resourced corporations well versed in such matters;*
  - *the proposed Rule would, in some cases, appear to needlessly duplicate information that is already provided in many state jurisdictions – particularly as it relates to contestable distribution connection works; and*
  - *the various state-based licensing arrangements would presumably result in a relatively small number of readily identifiable prospective service providers offering to contest the ownership and operation of network infrastructure (as distinct from its construction), reducing any informational advantage as it relates to these services;*
- *the proposed Rule is likely to impose significant regulatory and administrative costs on network service providers that will be required to construct and maintain comprehensive registers, with no obvious offsetting benefits;*
- *the potential accreditation and legal costs that would confront incumbent network service providers will likely be considerable;*

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<sup>3</sup> Draft Rule Determination, page 9

- *the proposal appears to entail a significant element of duplicity that impinges on existing jurisdictional arrangements, which may needlessly inflate costs and cause unnecessary confusion and uncertainty;*
- *the administrative role contemplated by the proponent is not one that should appropriately be assigned to incumbent network service providers; and*
- *the additional costs associated with the proposed Rule may inefficiently impact on network users through higher network service charges in a non-transparent fashion<sup>4</sup>.*

### **3.0 Response to the AEMC's Decision**

Energy Solutions has condensed the AEMC's decision to the following core issues:

- It has not been demonstrated that there are significant impediments to competition and indeed the jurisdictional registers would appear to suggest otherwise.
- The proposed Rule unnecessarily duplicates jurisdictional arrangements, and therefore imposes significant unnecessary costs.
- Clause 5.3.3(b)(3) of the Rules adequately addresses many of the concerns regarding the competitive advantage of the incumbent network service provider.
- It is not appropriate that the incumbent network service provider take on the administrative role associated with the proposed Rule.

Each of these aspects of the AEMC's decision is addressed in turn.

#### **3.1 Impediments to Competition**

The AEMC has stated that *'on the basis of the information provided in submissions, and its own analysis, the Commission is not satisfied that the proposed Rule<sup>5</sup>'* will *'indeed promote competition and potentially further the national electricity market objective<sup>6</sup>.*

##### *3.1.1 Information provided in the Submissions*

The AEMC has noted that *'it received sixteen submissions, the majority of which did not support the Rule change<sup>7</sup>.*' That the majority of submissions did not support the proposed Rule is not surprising given that the majority was from network service providers and related bodies.

Of those submissions that support the proposed Rule:

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<sup>4</sup> Draft Rule Determination, pages 2 and 3

<sup>5</sup> Draft Rule Determination, page 9

<sup>6</sup> Draft Rule Determination, page 8

<sup>7</sup> Draft Rule Determination, page 1

- AGL Hydro and Bovis Lend Lease considered that the issues addressed by the proposed Rule were *'real and substantive.'*
- Origin Energy agreed that there was an informational advantage that favoured the incumbents.
- AGL Hydro noted that there was a lack of alternative service providers and that therefore contracts were generally signed with the incumbent. Origin Energy also noted that there was a lack of alternative service providers.

Of those submissions that did not support the proposed Rule, none appeared to focus specifically on competition issues.

### 3.1.2 *The AEMC's Own Analysis*

The AEMC has noted that *'a large number of firms registered on various jurisdictional websites are ostensibly ready and able to provide contestable network services, and evidence exists that competition is occurring'*<sup>8</sup>.

However, as previously observed by Energy Solutions<sup>9</sup>, the jurisdictional arrangements require that design, construction and/or installation technical standards or requirements for contestable works are set by the local electricity distributor, because it is the incumbent network service provider that takes ownership of the works. That is, the jurisdictional registers do not register the interest of parties wishing to own the works in competition with the incumbent network service provider.

On that basis the AEMC is correct in concluding that *'evidence exists that competition is occurring'* in construction. However, the AEMC's analysis does not provide any evidence that competition in ownership is occurring.

### 3.1.3 *Information provided Elsewhere*

Queensland Alumina Limited (QAL) (*'one of Queensland's largest electricity purchasers from the grid, with total electricity consumption of around 750 GWh per annum'*<sup>10</sup>) did not make a submission to the AEMC. However, in another forum QAL has recently stated:

*'Connection agreement negotiations, being the primary contractual protection for large customers, are generally offered by TNSPs on a 'take-it-or-leave-it' basis, are not subject to regulatory oversight, and are heavily weighted towards the transmission company'*<sup>11</sup>.

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<sup>8</sup> Draft Rule Determination, page 9

<sup>9</sup> Energy Solutions Australia Pty Ltd letter to the AEMC dated 13 October 2006

<sup>10</sup> Queensland Alumina Limited letter to the Australian Energy Regulator dated 9 February 2007 (**QAL Letter**), page 1

<sup>11</sup> QAL Letter, page 1

### 3.1.4 Discussion

The AEMC's analysis has not demonstrated competition in the ownership of contestable network services. In addition, other parties have confirmed:

- the existence of an informational advantage that is real and substantive; and
- a lack of alternative suppliers.

In fact not only are there impediments to competition, market failure is occurring and efficient outcomes are not being delivered viz

- While services are being provided, they are not being provided within the required time frame. For example, Power Industry News has reported that '*Ergon Energy is making regional Queenslanders wait for up to a year just to have their power connected*<sup>12</sup>.'
- Where services are being provided, customers are not able to find out '*the parameters of the standard service*<sup>13</sup>.'
- There is no customer choice and service is generally offered on a '*take-it-or-leave-it*<sup>14</sup>' basis.
- Negotiations with the (monopoly) service provider are '*generally one-sided*<sup>15</sup>' and '*with poor standards of service (reliability)*<sup>16</sup>.'
- Even large customers are '*price-takers*' and '*offers to provide the 'above standard' service cost significantly more than QAL can source itself, even using contractors that perform similar work*<sup>17</sup>.'

Energy Solutions concedes that removing the informational advantage (through the proposed Rule) may not be all that is required to promote competition and further the National Electricity Market objective. However, it is certainly a necessary step to achieve that objective.

## 3.2 The Proposed Rule does not Duplicate Jurisdictional Arrangements nor does it Impose Significant Unnecessary Costs

It is important that the proposed Rule does not duplicate the existing jurisdictional arrangements and therefore impose significant unnecessary costs.

### 3.2.1 The Jurisdictional Arrangements

A number of submissions (e.g. Energy Australia, AGL, Energy and Water Ombudsman NSW, Energy Networks Association and Country Energy) considered that the proposed Rule did not adequately consider the jurisdictional arrangements.

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<sup>12</sup> Power Industry News Edition 527 as reported in the Courier Mail

<sup>13</sup> QAL Letter, page 3

<sup>14</sup> QAL Letter, page 3

<sup>15</sup> QAL Letter, page 3

<sup>16</sup> QAL Letter, page 3

<sup>17</sup> QAL Letter, page 5

The AEMC also highlighted the jurisdictional arrangements.

However, as previously observed (refer to the Energy Solutions submission dated 13 October 2006) the jurisdictional arrangements require that design, construction and/or installation technical standards or requirements for contestable works are set by the local electricity distributor, because it is the incumbent network service provider that takes ownership of the works. That is, the jurisdictional arrangements do not register the interest of parties wishing to own the works in competition with the incumbent network service provider.

Therefore the registers in the proposed Rule only need to focus on network owners in order to avoid any duplication of jurisdictional arrangements.

### *3.2.2 Avoiding Significant Unnecessary Costs and Ensuring Costs are Minimal*

A number of submissions claimed that accreditation issues associated with the proposed registers would impose significant unnecessary costs. This is not correct if the registers focus only on network owners.

In particular, network owners already face accreditation requirements through the existing legislation e.g. registration with NEMMCO, the need to obtain approvals from state based bodies e.g. the South Australian Office of the Technical Regulator, the Victorian Office of the Chief Electrical Inspector, etc.

To require a separate accreditation for the proposed registers would duplicate these state and national arrangements and is therefore unnecessary. In summary therefore:

- the registers only need to focus on network owners; and
- given existing legislation, there are no accreditation issues that need to be addressed by the incumbent network service provider.

Therefore not only are significant unnecessary costs avoided, but any costs should be minimal.

### *3.2.3 Discussion*

Requiring that the proposed registers focus only on network owners means that jurisdictional arrangements are not duplicated, avoids significant unnecessary costs and keeps costs minimal.

## **3.3 Clause 5.3.3(b)(3) of the Rules does not Adequately Address the Issues**

The AEMC has argued that Clause 5.3.3(b)(3) of the Rules, taken in combination with the fact that larger customers are sufficiently well informed, adequately addresses many of the concerns regarding the competitive advantage of the incumbent network service providers. However, the AEMC's position is not supported by the available evidence.

In particular, Evans and Peck recently surveyed a number of large Queensland customers i.e. *‘typically with annual electricity spend of \$5 million or more’*<sup>18</sup>.

Evans and Peck identified that:

- *‘all Electricity Users – regardless of their size – had a view that Network Service Providers took advantage of their monopoly positions’*<sup>19</sup>.

That is, Clause 5.3.3(b)(3) is not effective (as claimed by the AEMC) in addressing *‘the concerns expressed by the proponent and in submissions about the potential competitive advantage of the incumbent network service provider.’*

- *‘Almost all Electricity Users had an inadequate understanding of the process of establishing connection arrangements and the regulatory regime and constraints around the process’*<sup>20</sup>.

In fact *‘a significant number of users did not completely understand the differences between a Connection Agreement and a Retail Electricity Supply Agreement’*<sup>21</sup>.

That is, larger customers are **not** *‘well versed in such matters.’*

- No users *‘felt that the legislative framework or rules facilitated the process or making the NSP negotiate...’*<sup>22</sup>. Rather, *‘any who had attempted to put an agreement in place were of the view that the NSP simply tabled their standard agreement and were unwilling to negotiate around any terms of the agreement’*<sup>23</sup>.

Evans and Peck noted that its findings are not just confined to Queensland. Rather, they are valid more generally across the whole National Electricity Market *‘because many of the larger users interviewed had facilities in other states’*<sup>24</sup>.

Further, QAL has stated:

*‘Large customers/retailers have no more choice or leverage than small customers when negotiating with a monopolist transmission company. .... large customers are price-takers and service takers’*<sup>25</sup>.

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<sup>18</sup> Evans and Peck, *Review of Network Connection Arrangements for Large Electricity Users in Queensland, Final Report (The Evans & Peck Report)*, November 2006, page 7

<sup>19</sup> The Evans & Peck Report, page 9

<sup>20</sup> The Evans & Peck Report, page 17

<sup>21</sup> The Evans & Peck Report, page 8

<sup>22</sup> The Evans & Peck Report, page 9

<sup>23</sup> The Evans & Peck Report, page 10

<sup>24</sup> The Evans & Peck Report, page 6

<sup>25</sup> QAL Letter, page 3



Therefore the evidence does not support the AEMC’s position and in fact confirms market failure.

### 3.4 It is Not Appropriate that the Incumbent Network Service Provider take on the Proposed Role

The proposed Rule suggested that the incumbent NSP maintain the required registers. In so doing Energy Solutions recognized that this relied on the ‘good-will’ of the incumbent network service provider.

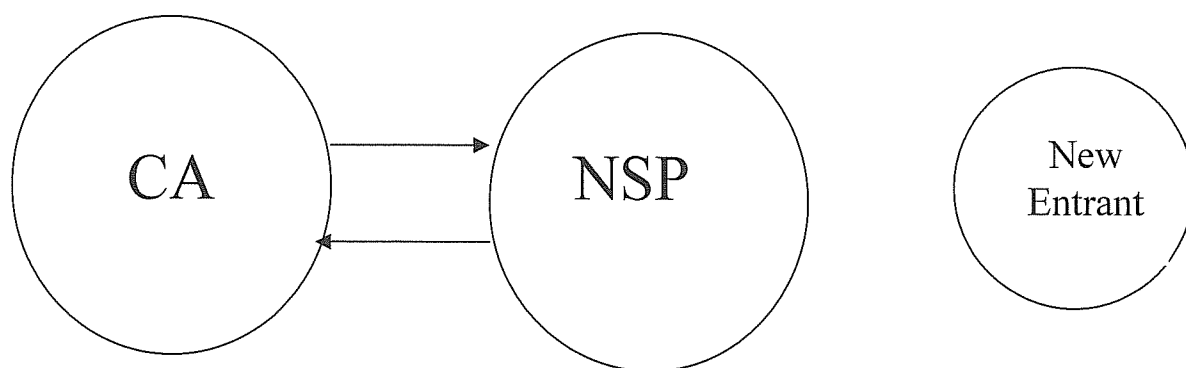
Regarding the appropriate party to maintain the registers:

- EnergyAustralia argued that the incumbent NSPs are not the appropriate parties; and
- various parties (e.g. EnergyAustralia, Electricity Transmission Network Owners, Energy and Water Ombudsman NSW, Energy Networks Association, VENCORP and Country Energy) argued that for each NSP to maintain a single register was inefficient and a single register was required.

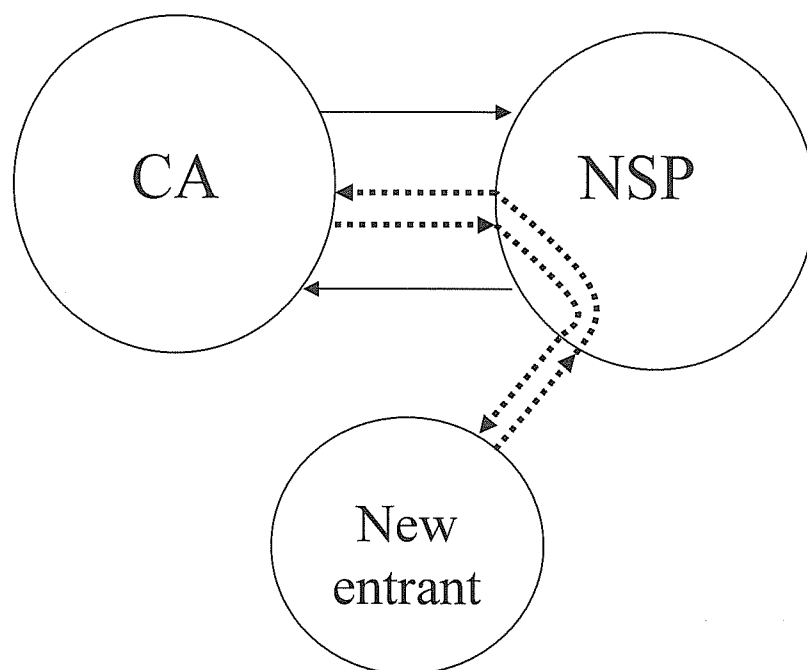
The proposal that the NSPs maintain individual registers was based on what was considered the best way to expand the information flow to include a new entrant network owner. In particular, Figure 3.1 illustrates the information flow under the existing Rules. It demonstrates that at present the new entrant is sidelined and out of the picture. Figure 3.2 illustrates the information flow under the proposed Rule. It demonstrates that under the proposed Rule the new entrant is included in the information flow.

If the AEMC considers that it is inappropriate that NSP’s do not maintain separate registers, then consideration needs to be given to:

- How well do the proposed arrangements enable the new entrant to be included in the information flow? and
- It is considered preferable that the party maintaining the registers should have obligations under the Rules.



**Figure 3.1** The Information Flow under the Existing Rules



**Figure 3.2** The Information Flow under the Proposed Rule

#### 4.0 Conclusion

It is clear that the basis of the AEMC's decision is not supported by the available evidence. Rather, the evidence is that when it comes to ownership of connection network services there are impediments to competition through the exercise of monopoly power by the incumbents and that market failure is occurring. Of particular concern is that the market failure is not transitory and is likely to continue:

*'The current workload and level of enquiries for connection arrangements is significant and likely to continue'<sup>26</sup>.*

The AEMC has stated that it *'wholeheartedly supports the promotion of competition in energy markets'<sup>27</sup>.* The proposed Rule is an opportunity for the AEMC to initiate a necessary step to deliver a level playing field between the incumbent network owners and new entrants. It is therefore a prerequisite to address the present market failure and in order for effective competition to emerge. The AEMC therefore needs to further consider this matter.

<sup>26</sup> The Evans & Peck Report, page 2

<sup>27</sup> Draft Rule Determination, page 8