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Wednesday, 8 August 2012

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

Dear Mr Pierce,

**RE: Clean Energy Council response to Grid Australia Supplementary Submission on Connections**

The Clean Energy Council (CEC) is writing to the Commission in response to the recent publication of the above supplementary submission to the Transmission Frameworks Review (Review).

While the CEC's view is consistent with the Commission that the treatment of connections in the National Electricity Rules (NER) requires attention, it is also the CEC's view that National Electricity Objective (NEO) takes priority when considering alternative options for reform.

In the recent response to Grid Australia's submission by PricewaterhouseCoopers the CEC stated the belief that

*"the National Electricity Rules envisages connection negotiations between two equally resourced and powerful entities: the connection applicant and the transmission network service provider (TNSP). The rules intend that the National Electricity Objective (NEO) is best met as an economically optimum outcome should be realised under this condition. Commercial arbitration supports the process by presenting a risk of a non-favourable outcome for either party."*<sup>1</sup>

In that response the CEC presented evidence that this framework is failing by pointing the Commission to the numerous submissions to the Review made by generators, and some of Australia's largest organisations. With these points in mind there are a number of aspects of Grid Australia's 'Conceptual Design' which require further attention. These are discussed below.

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<sup>1</sup> Clean Energy Council, 2012, *Clean Energy Council - response to Grid Australia's supplementary submission*, p. 1, available: [www.aemc.gov.au](http://www.aemc.gov.au).

## Application of the Conceptual Design to economic principles

Grid Australia states that the *“Conceptual Design must be consistent with the current principles of economic regulation that apply to prescribed transmission services and negotiated transmission services, as they apply to a transmission system regulated by the Rules”*<sup>2</sup>.

It is important to note that the form of economic regulation applied to connections is negotiation which is a form of indirect regulation, rather than a form of direct regulation such as is applied to prescribed transmission services. Connection negotiations are guided by each Transmission Network Service Provider’s Negotiation Framework and NER clause 5.3.6(f)<sup>3</sup>.

Despite the current framework the Conceptual Design reduces the scope of negotiable matters and places a number of aspects into the control of the TNSP. For example, the Conceptual design states that the TNSP will determine *“the amount of power transfer capability that is available from its transmission network”*<sup>4</sup>. Under the current arrangements this is a direct function of the NER Schedule S5.2 access standards whereby sufficient power transfer capacity is implicit in compliance with the relevant automatic, negotiated or minimum access standards.

The Conceptual Design intends to limit the scope for negotiations. However, and as discussed above, the NER assumes that the ability to negotiate is the most efficient means of achieving the NEO. Therefore any process or rule changes subsequent to the Review should focus on supporting effective negotiations, rather than limiting them.

In addition to the above the recent submission from Grid Australia argued against the case for the application of economic regulation to transmission services and states that *“... proceeding directly to the question of how to regulate is inconsistent with mainstream regulatory economic principles. Rather, the first and most substantial question is whether regulation is justified at all, with the form of regulation only assessed if that hurdle is met”*<sup>5</sup>.

In this case the process which Grid Australia is seeking to regulate is essentially the negotiation of a contract for the design construction operation and maintenance of electricity assets. This negotiation is occurring at the interface between participants in the competitive electricity market, with participants and in what is considered to be a regulated market. The assumption being made here is that because a large part of the TNSPs’ activities relate to service provision to consumers which is regulated that the connection process for generators and load should also be regulated, which is

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<sup>2</sup> Grid Australia, 2012, *Transmission Frameworks Review First Interim Report – Supplementary Submission on Connections*, p. 2, available: [www.aemc.gov.au](http://www.aemc.gov.au).

<sup>3</sup> NER Clause 5.3.6(f) states *“Both the Network Service Provider and the Connection Applicant are entitled to negotiate with each other in respect of the provision of connection and any other matters relevant to the provision of connection and, if negotiations occur, the Network Service Provider and the Connection Applicant must conduct such negotiations in good faith”*.

<sup>4</sup> Grid Australia, 2012, *Transmission Frameworks Review First Interim Report – Supplementary Submission on Connections*, p. 3, available: [www.aemc.gov.au](http://www.aemc.gov.au).

<sup>5</sup> Grid Australia, 2012, *Transmission Frameworks Review First Interim Report – PwC Report on the Case for the Application of Economic Regulation to Transmission Services*, p. 2, available: [www.aemc.gov.au](http://www.aemc.gov.au).

inconsistent with the economic principles offered previously when arguing against economic regulation.

### **Consistency of the Conceptual Design with the Competition and Consumer Act 2010**

Grid Australia states that the “*Conceptual design must also be consistent with Part IIIA of the Competition and Consumer Act 2010, in particular the criteria for certification of effective State based access regimes*”<sup>6</sup>. Part IIIA of the act requires that the service provider in each jurisdiction develops an ‘*access undertaking*’ document which details matters relevant to any entity seeking access to the service provider’s assets.

In the case of a TNSP the access undertaking document is the existing Negotiation Frameworks. Despite this the proposed Conceptual Design overlooks the importance of negotiations in achieving the NEO and appears to imply that an entirely new framework or *access undertaking* would be established.

In most cases TNSPs approach connection negotiations with a focus on NER Chapter 6A, which sets out the framework for economic regulation as agreed between the regulator and TNSP, without consideration of other market participants. This approach is demonstrated in the proposed Conceptual Design where the Chapter 5 processes and the importance of the technical content of that chapter have been overlooked.

It is the CEC’s view that the connection process requires sufficient support to facilitate effective negotiations, and thus efficient connections with regards to the NEO. This support should be provided through enhancements to the current processes, not by redesigning the process.

### **Achieving an Offer to Connect through NER Chapter 5**

Grid Australia’s proposed Conceptual Design is premised on the following statement:

*“The offer to connect processes in Chapter 5 of the Rules is complex and prescriptive and it should be reviewed and streamlined to reflect the minimum level of process needed to achieve the outcomes referred to above. In addition, the offer to connect process should be flexible to provide for different contracting arrangements between a TNSP and a customer (for example construction of works and provision of functional transmission services) to meet the customer’s needs and project timelines”<sup>7</sup>*

Market participants experienced with generation projects work through the NER Chapter 5 processes frequently. Importantly no submission to the Review from a generator has argued that reaching an

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<sup>6</sup> Grid Australia, 2012, *Transmission Frameworks Review First Interim Report – Supplementary Submission on Connections*, p. 2, available: [www.aemc.gov.au](http://www.aemc.gov.au).

<sup>7</sup> Ibid, p. 4.

offer to connect through NER Chapter 5 is overly 'complex' or 'prescriptive', suggesting that the proposed Conceptual Design is an extreme and inappropriate reaction to market concerns. Again this demonstrates the tendency of TNSPs to overlook the importance of NER Chapter 5, as there is a desire to only respond within the requirements of Chapter 6A, when considering connection applications.

In the CEC's view the Chapter 5 connection process strikes an excellent balance between necessary technical performance and efficient connections. It does this by prescribing the information which a TNSP must disclose so that the connection applicant can demonstrate generator performance against set benchmarks. There is scope for negotiation on matters where system security and reliability are not put at jeopardy. This negotiation then allows the connection applicant to make efficient decisions by trading off equipment size and cost against necessary performance indicators. By design it also recognises that these decisions are best placed with the party funding the connection rather than a third party TNSP, thus supporting efficient connections with regards to the NEO.

The CEC agrees with Grid Australia that contracting arrangements should be more flexible, and contends that this flexibility should be extended to contestable provision of connection services. However, the proposed Conceptual Design does not clearly outline how such an arrangement would be incorporated. Rather it seems to imply that this arrangement would not be allowed, which is inconsistent with the objectives of the Review in the exploration of increased economic efficiency for connections.

If the development of the Conceptual Design is to be based on economic principles, as claimed, the true starting point for the development of a Conceptual Design is to assume that a competitive process should apply (as competitive processes are more efficient than regulated processes), and an economic justification established for regulation would need to be developed subsequently if found to be applicable. In the recent Grid Australia submission the point is made that the costs of regulation are high, the mere presence of market power is not sufficient to warrant the application of regulation and that a high threshold must be met before regulation is applied even if in the real world the market may only be workably competitive<sup>8</sup>. Therefore, the assumptions underlying the basis for any regulation of connection activities must be questioned.

The CEC is of the view that there is no technical reason why connection services cannot be provided on a workably competitive basis and that approach should be facilitated with regulation provision being a fall back.

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<sup>8</sup> Grid Australia, 2012, *Transmission Frameworks Review First Interim Report – PwC Report on the Case for the Application of Economic Regulation to Transmission Services*, p. ii, available: [www.aemc.gov.au](http://www.aemc.gov.au).

## Closing

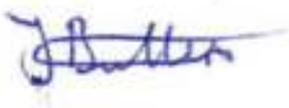
On the basis of the above discussion it is not clear that Grid Australia's Conceptual Design is intended to inform the Commission's goals as set out in the Review, whilst considering the NEO. Rather, much of the proposal appears to be based without support, and with the intention of enhancing the current position of monopoly TNSPs, while reducing the scope for negotiations to realise their intended efficient outcomes.

The CEC's view is that Grid Australia has demonstrated that TNSPs overlook the importance of NER Chapter 5 and focus on Chapter 6A in the negotiation process. As a result the detail in Chapter 5 has been reported by TNSPs to be a hindrance to the process, rather than recognised in its effective function of support to the NEO. This issue can be managed through incremental changes to the appropriate parts of Chapter 6A to better recognise the TNSP's Chapter 5 obligations, rather than reproducing the connection process as proposed in Grid Australia's Conceptual Design.

The CEC reminds the Commission that the complexities of achieving an offer to connect through NER Chapter 5 have not been brought into question by the Review, the focus of which is on enhancements to the negotiation framework and connection cost efficiency through regulation or contestability. Although imperfect, the Chapter 5 connection process represents best practice in numerous ways, and should be better integrated into the practices of TNSPs, rather than considered as an externality to TNSP processes.

Please do not hesitate to contact the undersigned for any queries regarding this letter.

Yours sincerely,



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