Mr John Pierce
Chairman
Australian Energy Markets Commission
PO Box A2449
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Lodged via the AEMC website

3 February 2012

Dear Mr Pierce

EPR0019 Transmission Frameworks Review – First Interim Report

The Private Generators listed on the side-bar welcome the opportunity to make a submission in response to Australian Energy Market Commission's (AEMC) First Interim Report (Report) on the Transmission Frameworks Review.

This submission provides comments on the connections related issues discussed in the Report. Individual submissions will focus on the other aspects of the Report.

Defining the problems and preferred options to address them

We agree that the AEMC has captured accurately the problems related to network connections. Improving the clarity and transparency of the connection process, including definitions, can greatly improve the efficiency and timeliness on new connections.

A key step in clarifying the connection process is to review whether the current roles and responsibilities defined in that process continue to be appropriate. The current rules do not deliver an appropriate level of competitive tension to promote cost-effective and timely connection services given the negotiating power asymmetries between the connecting party and the incumbent monopoly Network Service Provider (NSPs). This creates an inefficient connection process, particularly in relation to time and cost blowouts with connection projects where the control primarily lies with the NSPs.

To address these framework problems, we generally support the AEMC's proposed options with some clarifications and additions:

- **Option 1:** Improving the dispute resolution process can enhance the negotiating power of connecting parties. Having access to a more timely, accessible and reliable process is a key tool to resolving impasses in the connection process. The structure of the reformed dispute process depends on the extent of changes to the connection process itself, particularly how frequently the dispute process could be used. The primary reforms need to focus on improving the connection process itself; this can reduce the

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likelihood for requiring use of the dispute process. This is discussed further in Section 2 of the attachment.

- **Option 2:** Strengthening the negotiated framework for connections can deliver significant efficiencies to the overall connection process. A crucial part of this is giving the connection party the power to determine whether or not there is sufficient contestability to deliver connection services. This increases the prevalence of the negotiated framework, redefining all connection services as negotiated services unless otherwise determined by the connecting party. Improving the information, cost allocation, time requirements and transparency provisions of the negotiated framework are also imperative reforms. We discuss this option further in Section 1 of the attachment.

We consider the anecdotal evidence provided in previous submissions sufficiently articulates the problems with the connections process and need for these reforms. The AEMC should not discount such evidence because it does not provide specific and detailed examples. Confidentiality provisions in connection agreement contracts can limit the ability to publish specific information in submissions.

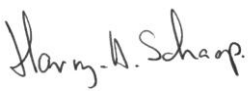
In addition, many new connections are likely to be small scale ventures. Historically, new power stations have tended to be large scale plant. To ensure the expected increase in connections requests are met in a timely and cost effective way, the connection process needs to empower these smaller parties in particular, given they will have fewer resources to engage with timely and costly negotiations with NSPs. The recommendations set out above and explored in this submission's attachment go a substantive way to address this.

This submission's attachment elaborates on the following:

- Section 1 details a preferred connection process, which includes clarifying roles, responsibilities and definitions, improving information transparency and sharing and suggesting standard contract terms and conditions.
- Section 2 outlines the important role of dispute resolution.
- Section 3 explains why reclassifying prescribed transmission services (Option 3) is a suboptimal and disproportionate solution.
- Section 4 discusses other relevant issues, including linkages with the concurrent AEMO Victorian Connections Initiative Review and the important of technical standards

Should you wish to discuss this submission further, please contact Hannah Heath (Origin Energy) on (02) 9503 5500 of hannah.heath@originenergy.com.au.

Yours sincerely



Dr Harry Schaap
(on behalf of the listed generators)

ATTACHMENT

1. Preferred connection process

A connection process that is clear, predictable, timely, cost effective and transparent, flexible and efficient is likely to promote the National Electricity Objective and be in the long term interest of consumers. To achieve this, we support:

1. A clear process, including definitions and timing (where possible):
    - Clearly defined roles, responsibilities and accountabilities as well as an enforceable negotiating process.
    - Appropriate incentives for NSPs to negotiate (in good faith).
    - Explicit requirements for NSPs to be the default provider for connection services under the negotiated framework.
2. Default classification of connection services as negotiated services with the power for the connecting party to "opt out" if they determine there is sufficient contestability to deliver some or all of their connection services (Modified Option 2).
3. Transparent information sharing between negotiating parties – manage information asymmetry, providing information upfront to avoid surprises (Option 2).
4. Standardisation as a starting point where possible – but provide flexibility to negotiate alternative arrangements (Option 2).
5. Efficient dispute resolution process, as required (Option 1).

We discuss each of these in turn below.

1.1. Clear connections process

The current definitions around transmission services are complicated and challenging to understand. Creating particular uncertainty is the circular link that the cost allocation of these services determines their status but the status is determined by the cost allocation. For example NER classifies services as prescribed, negotiated or contestable connection services dependent on whether the NSP recovers the costs by setting a Transmission Use of System (TUOS) charge or negotiating the charges directly with the connecting parties.

This creates ambiguity surrounding what constitutes a connection asset and services and the applicable cost allocation methodology. The NER definitions need to separate the classification of a service from the methodology used to recover its costs. A clear definition and stated purpose for each connection asset and service can reduce this ambiguity. Once it is clear what service is being delivered and its beneficiaries, the NER can then specify the appropriate cost allocation methodology. For example, if an augmentation to the shared network relieves a constraint that benefits a large group of end users, then it is likely that this service would be classified as a prescribed service. The NER would then explain how to recover prescribed transmission services, which in this case is through a TUOS charge.

This is a very simplistic example and when it comes to connection services the definitions may not be as clear cut. However, it does provide a guide as to why separating the definition from the cost recovery methodology can improve the clarity of the connection process.

The connection process itself also needs to align more closely with the commercial realities of negotiating a network connection. As raised in earlier submissions, part of this relates to separating the process into different stages that reflect the financial and decision milestones for a new investor. This stronger link can improve the efficiencies of the process for both the NSP and the connecting party.

Improving the incentives for NSPs to negotiate in good faith and deliver efficient connections, in both cost and time, is a key element in the proposed framework put forward in this submission. The NER needs to clarify that NSPs have a requirement to deliver connection services. While there is a requirement in the NER to provide transmission services, this can be more specific to apply to connection services.

To do this, we recommend revisions to the connection framework. The default safety net arrangement is a requirement for the NSP to connect an applicant to the network using the negotiated framework. Providing the connection applicant with access to non-regulated, contestable services is desirable where the applicant deems there to be sufficient competition from alternative service providers. This reform improves the defined roles and responsibilities on the connection process.

The next section elaborates on this recommendation.

New base case – connection services are negotiated transmission services

The proposed framework moves the decision-making on whether or not there is sufficient contestability to the counterparty benefiting from those competitive tensions. This helps rebalance the current negotiating asymmetries arising from the NSP having the power to determine what is, and what is not, contestable and therefore a non-regulated versus a negotiated service.

Under the current regime the default position is for some classes of connection services to be deemed contestable, non-regulated services. The information asymmetry between connecting parties and the Rules favours NSPs in making this determination. The connection applicant is unable to refute or contest this contestable determination.

The Private Generators support competition in the provision of connection services, where possible. Competition is an important incentive to achieve efficient connections. The mechanism to facilitate competition is to shift the arbiter of a contestable service from the monopoly NSP to the connection application being the beneficiary of competition. For example, under this regime the connection applicant could be able to tender for 'Expressions of Interest' for the design, construction and maintenance.

The proposed framework empowers the connecting party to find alternative providers for the connection service. This provides commercial opportunities and incentives for NSPs to tender and compete for connection services. These changes enhance the clarity, consistency, predictability and equity to the connection process irrespective of the size of the connection applicant. In doing so, it does not disadvantage NSPs.

There are some practical considerations. For instance, there are some challenges today with the practice of a connection applicant funding a connection service then gifting or offering the asset to

the NSPs at a low cost. This does not appear to be tax effective for either the connecting party or the NSP because of the implications for depreciation allowances and stamp duty. The financial implications can limit the contestable options when it comes to sourcing connection services. These are important issues for the AEMC to consider so that neither the connecting party not the NSP are placed at a financial disadvantage.

The proposed connection regime strikes a more equitable balance between facilitating competition for connection service provision while retaining an appropriate safety net to enable a generator to connect efficiently.

Commercial driver determine the level of contestability

As discussed above, this group of Private Generators supports competition in providing connection services where possible. Competition will drive increased efficiency through enabling the connection parties to contract on commercial terms. This assists in removing the existing information and negotiating power asymmetries where the NSP determines what is contestable.

We consider connecting parties are better placed to determine whether or not there are commercially viable alternatives. It is also a more simple solution than trying to define an efficient level of contestability for the NSP to determine. The connecting party already has a vested interest to find the most cost effective and timely solution.

If the framework is set up as proposed, there is no requirement for a test to determine the level of contestability; commercial drivers act as the test. This competitive and flexible framework reform allows the connection applicant to 'opt out' of the negotiated transmission services where it is commercial to do so.

There is a question on the level of pure contestability for providing connection services. Connection design, construction, operation and maintenance are all interrelated when it comes to negotiating a connection to the shared network. For instance, is a connection service truly contestable if the NSP sets the design for the terminal station? These are practical applications and considerations that need to be worked through further.

The connecting generator would be obliged to design, construct and maintain the connection using a registered Network Service Provider as currently stipulated in the Rules. The connection would be to the technical standards of the incumbent NSP given the varying characteristics of high voltage networks.

1.2. Improving information transparency and sharing - Option 2

The Private Generators support Option 2. However, the submission goes further for improving information transparency and sharing. A framework based on these principles can be subdivided into the provision of information and prescribing standard terms and conditions.

Under the existing framework, the Rules are ambiguous surrounding information sharing with connection enquires and agreements placing the connection applicant at a disadvantage. This is

typified through the connection process where there is no obligation to publish a schedule of costs and, where costs are provided, the NSP has significant latitude to revise those costs.

This asymmetry in the Rules can limit the ability for connecting parties to hold the NSP accountable. Connection applicants have limited recourse where NSPs have the capability to revise costs and the timeframe for the completion of connection projects. This places a disproportionate allocation of the financial risk for a project in time and component cost on the connection applicant.

Publishing a cost schedule early on in the connection process can assist connection applicants in estimating connection costs in different locations across the network. A standardised format for the schedule can improve the consistency of information from NSPs to connection applicants across the NEM.

A central feature of the proposal to increase the level of information and transparency is to increase the role of the connection applicant in the connection process. The asymmetry in the rules favouring the NSP can be reduced by allowing for commercial considerations to be incorporated into the Rules. Increases in information and transparency provides for making the connection process more equitable and dynamic between connection parties.

Under the current regime, uncertainty increases the risks and financial cost of connection projects. Having timely and transparent information decreases these risks through alleviating the uncertainty for the costs of component parts and the allocation of those costs between the connection applicant and the NSP. Varying interpretations of the Rules by regional NSP exacerbates this uncertainty and risk.

The ability for a connection applicant to manage financial risks and exposures is central to the maintenance of the businesses risk management framework. It is not possible to effectively manage a stress test or other measure of financial exposure where cost changes occur and these changes are not communicated to the connection applicant. Risk management frameworks ensure financial exposures do not pose risk to servicing debt obligations, maintain credit ratings and the ongoing viability of the business. Cost variations and delayed communications of the changes run counter to sound business risk management.

The cost from a lack of timely and transparent information flows onto to broader business risks. These include difficulties for effectively budgeting for projects and the ability to optimally value contracts. Increased uncertainty also extends to decisions participants may make around hedging positions where the duration of the connection is unclear or revised.

With an increased role for the negotiated framework, there may be value in reviewing the current process for approving an NSP's cost allocation methodology for negotiated transmission services. Under the current regime, a NSP is required to submit a cost allocation methodology to the Australian Energy Regulator (AER) for approval. It is important for that process to be transparent and to provide and appropriate balance between prescription and flexibility. Ensuring a sufficient level of detail is important, particularly as a means for minimising the probability of disputes around allocation.

We encourage the AEMC to consider facilitating discussions between NSPs and interested stakeholders to help identify ways to increase information sharing and transparency of asset and service costs and their timing across the connection process.

1.3. Standard Terms and Conditions – Option 2

The Private Generators support the introduction of standard terms and conditions contract for connections. We consider this recommendation goes further than what the AEMC proposes in its Option 2. Standard terms and conditions can help provide regional consistency through a contract developed and endorsed by industry.

The objective for the standardisation of terms and conditions is to reduce the time and cost associated with negotiating items that are, generally, consistent across regions. Differences in terms and conditions across regions in a single NEM ought not to be a defining feature of that market.

A further benefit of the development of a standard contract for terms and conditions is the reduction in time pressures. A standard contract can provide more time to negotiate on more crucial aspects of a connection, like the design and technical standard features. This can improve the quality and timeliness of connection negotiations.

It is important for a standard contract to meet the interests of NSPs and connecting parties in a balanced way. This could be achieved through facilitated discussions between generators and NSPs. The AEMC can play an important role in those discussions.

Developing a standard contract can assist in promoting reasonable terms for both parties involved. This can promote consistency, clarity and predictability in connection agreements across regions. Negotiating these terms outside the time critical connection process can assist in managing the inherent information and power asymmetries between NSPs and connecting parties.

There are aspects of a connection agreement that are not necessarily appropriate for a standard contract. For example, site specific issues relating to power system security implications are likely to be agreed on a case by case basis.

A list of possible areas where common standard terms and conditions could be identified includes:

- Clearly defined risk allocation and obligations, particularly relating to liability and indemnity (including consequential loss, intellectual property) – who is responsible for what?
- Prudential requirements/credit support
- Dispute resolution/arbitration
- GST and taxation
- Time delays, including enforceability
- Changes in law
- Invoicing and payment terms
- Financial recovery on early termination.

We support the AEMC in pursuing a facilitation role to help NSPs and interested stakeholders develop a common set of terms and conditions.

1.4. Prescribing a level of WACC for connection services

Option 2 discusses the need for prescribing a regulated Weighted Average Cost of Capital (WACC) in the NER for negotiated connection services.

At this stage, we are not sure whether or not the NER needs to prescribe a WACC for connection services. The principle underpinning the framework proposed in this submission is for competitive pressure to provide NSPs with a commercial incentive to compete for contestable connection services. Any setting needs to be flexible enough to allow for adjustments as funding costs can vary. This is clearly demonstrated through external factors, like the current international economic conditions and their influence on funding costs. We agree with the AEMC that there are a number of challenges around determining an appropriate WACC level and prescribing that in the NER.

If the negotiated framework is sufficiently robust, clear and transparent, this may provide a sufficient platform for connecting parties and NSPs to negotiate a cost allocation framework, which includes the level of WACC.

2. Dispute resolution – Option 1

The Private Generator support improvements to the dispute resolution process. We note that no connection applicant has utilised the AER dispute resolution process to date. This suggests that connecting parties find the current process challenging and inaccessible and not that the current connection process is satisfactory. In addition, the underutilisation of dispute resolution could also be related to the potential risk and negative consequences of antagonising a monopoly NSP by using the process. An independent accessible, timely and credible dispute resolution process has the ability to provide an accessible tool to progress negotiations that have stalled.

While important, we believe an effective dispute resolution process is not the main game. It is important to focus on addressing problems in the connections process to reduce the need for dispute resolution and arbitration. The proposal discussed above involves the implementation of increased competition into the connections regime facilitating increased contestability. The improvement in the negotiating framework this involves should decrease disputes through a reduction in information and power asymmetries between connecting parties.

As such, the form of the dispute resolution process depends on the changes made to the connections process. Until the form of this process is known, it is not possible to make firm recommendations on the structure of the dispute process or the selection of judicators. This would depend on how frequently the dispute resolution process is used.

3. No support for Option 3 – Prescribed transmission services

The Private Generators do not believe the AEMC's Option 3 offers any improvements to the current connection process. We believe defining connection services as prescribed services would be to the

detriment of the connections process and result in increased regulatory costs. The problems with the existing connections process is material as discussed above. However, to move all transmission services to being prescribed services is disproportionate and more likely to exacerbate existing problems.

The Private Generators believe the best way to address existing problems in the connections framework is to encourage competition where possible. Competitive tension within the connection process increases the number of NSPs available to tender for connection projects. This process places less regulatory costs on participants compared to a prescribed process.

4. Other relevant issues

4.1. Victorian Connections Initiative

The Private Generators note the AEMO Victorian Connections Initiative that is being undertaken in parallel to the Transmission Frameworks Review. It is important for these parallel processes to be consistent in their recommendations to reduce the probability of conflicting or inconsistent outcomes. The Private Generators support the AEMC's review of the Victorian connections regime and in particular the Victorian contractual arrangements, third party liabilities and obligations on generators in the shared network. However, while AEMO's thinking is further developed compared to the AEMC's that does not mean the particular recommendations in Victoria are necessarily appropriate for the NEM as a whole. Consistency in managing these processes is key and the AEMC has a role to review AEMO's recommendations from the perspective of promoting a consistent and robust NEM-wide connections framework.

4.2. Technical Standards

The current NEM technical standards reflect the historical investment in base load power station. Influenced by changing demand requirements and increasingly, environmental policies, peaking plant and renewable generation plant, like wind generation, are changing the generation mix across the NEM. As such, the Private Generators support a review of the technical standards to better represent and reflect the generation mix in the NEM. This can assist in reducing the time required to negotiate technical standards by making the starting point more reflective of the nature of new connecting plant.