

10 May 2013

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

Dear John,

Consultation Paper: Recovery of Network Support Payments Rule Change Proposal

SP AusNet welcomes the opportunity to make this submission in response to the AEMC's Consultation Paper on the Recovery of Network Support Payments Rule Change proposal.

SP AusNet proposed this Rule Change to address deficiencies in the ability of TNSPs and DNSPs to recover network support payments. In particular, the proposed Rule Change would:

- Allow NSPs to recover network support payments that relate to services providing an alternative to an augmentation of connection assets, and
- Enable DNSPs to pass through network support costs.

The current Rules have precluded SP AusNet from entering into network support agreements with embedded generators during the current distribution regulatory control period, even where these agreements represent the lowest cost solution to increase network capacity. Therefore, to enable efficient network investment, SP AusNet is seeking a rule change to allow recovery of these costs during the current regulatory control period.

The Rule Change is likely to contribute to the National Electricity Objective through removing the distortion of cost recovery arrangements favouring network solutions. This would allow DNSPs and TNSPs to consider network and non-network solutions on an equal footing, therefore promoting efficient investment in electricity services.

If you have further questions regarding the information provided, or would like to request further information to help assess this Rule Change proposal, please contact Charlotte Coster, Regulatory Economist on 03 9695 6309.

Yours Sincerely,



Alistair Parker
General Manager Asset Management

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Attachment – Responses to questions posed in the consultation paper

The questions contained in the Consultation Paper are addressed below.

1. Is the assessment framework presented in this consultation paper appropriate for assessing this rule change request?

SP AusNet considers that the assessment framework presented in the consultation paper is appropriate. However, when considering efficient costs it would be better not to limit the definition of efficient costs to those that are lower than the value of the benefit they provide. In some cases, there may be two options where this is the case, for example, both augmenting a network and entering into a network support service agreement may have benefits exceeding their cost. In this case it is the lowest cost option which should be deemed the 'efficient cost'.

2. Is the recovery of costs for network support service arrangements a material problem in the NEM? If so, please provide evidence to support your views.

In February 2011, SP AusNet, AEMO and United Energy published a Request for Information seeking non-network alternatives to a connection asset augmentation to install a 4th 220/66kV transformer at Cranbourne Terminal Station. An offer of 40 MW of network support was received which would have allowed the project to be deferred by two years. The cost for the network option was estimated at \$21.7m indicating the economic value of the two year deferral was around \$3.2m.

However, under the National Electricity Rules the network support payments could not be recovered. This was the event that prompted SP AusNet to seek this rule change.

Since this initial assessment, revised demand forecasts have postponed the need for this network support contract. However, current demand forecasts indicate network support at this location will become economic before the end of the current regulatory control period.

At current demand levels, an opportunity to establish a network support agreement of this nature is expected to occur once in five years (note that across the five distribution businesses in Victoria, this would equate to one agreement a year in Victoria). However, if demand growth returns to historic rates, this frequency could increase to once a year for SP AusNet alone.

SPI Electricity entered into a network support agreement with an embedded generator providing up to 40MW in Bairnsdale in 2001. Payments made to the generator reflect the benefits of deferring augmentation, specifically constructing and commissioning a terminal station in Bairnsdale, and establishing a transmission link between Morwell and Bairnsdale. The costs incurred as part of this agreement for the current regulatory period are included in Table 5.1 in the consultation paper. This agreement expires in 2020.

These costs are recovered through the annual pricing proposal process, as per transitional arrangements under the DNSP recovery of transmission-related charges Rule Change (24 March 2011). However, if there was another opportunity to enter into a similar agreement,

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under the current Rules SP AusNet would be unable to recover the costs of this agreement and would therefore have no incentive to enter this agreement, even if it were efficient to do so.

The expected frequency of the opportunity to establish a network support agreement similar to Bairnsdale is around once every 15 years.

However, while the problem is considered material, it does not seem that current materiality should be a key consideration when assessing this rule change proposal. This is because network support is a relatively recent development and should not be discouraged. This will allow businesses to learn from experiences with these arrangements, increasing the potential for network support services to benefit both customers and businesses in the long-run. In addition, as recognised, the materiality of demand side participation (DSP) projects is likely to increase in future. Barriers to network support arrangements proceeding will reduce their potential to become material and hence reduce the future benefits of network support service arrangements.

In addition, the inability of network service providers to recover costs is likely to be more material from the point of view of the generator than the NSP. Whether or not an NSP is willing to make these payments could determine whether or not the embedded generator is willing to provide network support at a particular point on the network. This could be true even if the network support were the most economic option for the NSP.

The October 2012 'Distribution network planning and expansion framework' Rule Change introduced demand side engagement obligations on distribution businesses. Facilitating the recovery of network support payments as per the proposed Rule Change would be consistent with the intent of this previous Rule Change regarding network support.

3. Should recovery of costs associated with distribution network support service arrangements be subject to full incentive regulation i.e. only permitted to be recovered as part of the revenue allowance?

Limiting the recovery of costs associated with distribution network support service arrangements to the revenue allowance is problematic for the following reasons:

- These costs are difficult to forecast – depend on a third party being willing to provide the network support at the location and at the time required for an acceptable price. Therefore, these are much harder to forecast at the time of determination than the costs associated with traditional augmentation.
- In Victoria, where DNSPs are responsible for planning transmission connection assets, transmission connection asset augmentations are normally passed through to DNSPs as part of exit charges, so no money is provided for these services in revenue cap. However, the December 2011 Rule Change determination (NSP and avoided TUoS for Embedded Generators) confirmed that it was not appropriate to pass through network support payments as alternatives to connection asset augmentations as part of the exit charge.

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- Limiting recovery to the revenue cap means that NSPs would have no ability to pass on additional costs that could arise within the current regulatory control periods. Victorian DNSPs would have to wait until 2015 to recover these costs.

Instead, the Rule Change proposal suggests that DNSPs should be able to recover network support service agreement costs through a specific pass through mechanism, mirroring that which is available for TNSPs. This ensures that both DNSPs and TNSPs are able to recover the efficient costs of network support services. This expenditure would still be subject to regulatory scrutiny by the AER, while reducing the risk associated with expenditure recovery which could discourage adoption of network support service agreements, even where these would be efficient.

The Rule Change proposal also recommends that the opex roll forward mechanism for network support payments for TNSPs is mirrored for DNSPs. This is to adjust the imbalance between opex and capex. Assuming a TNSP has not overspent the capex allowance during the regulatory control period, it is automatically rolled into the RAB. However, the AER assesses the efficiency of opex at each determination. As network support service agreements are likely to span several years, and therefore perhaps more than one regulatory control period, the continued recovery of network support service agreement opex is less certain than the recovery of capex associated with 'traditional' augmentations, which is likely to roll straight into the RAB. This was also recommended in PwC's report 'Incentives for network driven DSP' (October 2012) submitted to the AEMC during the Power of Choice review.

4. If distribution network support service arrangements were to be recovered through a pass through regime, is the current "nominated pass through" the appropriate mechanism? Or, should the current specific network support pass through and/or the opex roll forward arrangement apply?

As proposed, SP AusNet considers that a specific network support pass through should apply to distribution network support service arrangements. Prior to the December 2011 'Network Support Payments and Avoided TUoS for Embedded Generators' rule change, SP AusNet recovered costs associated with distribution network support service arrangements (such as Bairnsdale) via the annual pricing process. Figure 5.1 in the consultation paper demonstrates that to maximise regulatory certainty precluding this option, a network support pass through is required.

It is noted that the network support arrangements would only be entered into where they represent the lowest cost option for customers, as otherwise the expenditure would not be efficient. Introducing this pass through would maintain the incentive to adopt the lowest cost solution, consistent with the NEO, which promotes efficient investment. This is because the proposed specified pass through allows the AER to assess the efficiency of the network support agreement expenditure, including whether the magnitude of the network support payment could be reduced. In this way, there is regulatory scrutiny in same way that assessment as part of revenue determination would, but with the additional certainty for NSPs that it could potentially apply within a regulatory period. This is important because as stated above, network support service agreement payments are difficult to accurately forecast.

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A specific network support pass through is preferred over a nominated pass through for the following reasons:

- Could apply before the next regulatory control period
- Increases certainty of recovery of network support service agreement expenditure, particularly as these agreements can often span multiple control periods
- Would simultaneously apply to all TNSPs and DNSPs in the NEM

In addition, the AER would have longer to assess the pass through application, should a pass through event occur, if a specific, rather than a nominated, pass through applied (60 days instead of 40 days).

5. Are the differences between transmission and distribution sufficient to justify different cost recovery mechanisms for transmission and distribution network support service arrangements?

SP AusNet considers that it is the similarities and differences of the nature of the relationship between network support agreements and distribution and transmission businesses specifically that is relevant to answering this question.

Similar issues are faced by both TNSPs and DNSPs when engaging in network support agreements, particularly the issues related to the uncertainty in expenditure recovery.

The Consultation Paper states that:

‘Transmission projects are likely to be larger but less in number than distribution. In distribution, if distribution network support service arrangements are used for more numerous and smaller projects, the administrative burden on the AER to assess them may not be proportional to the net benefit of the projects’

However, while the sizes of the projects may differ, the number of network support agreements is currently relatively few for both TNSPs and DNSPs. Given that a network support event cannot be related to network support payments that are a substitute for network augmentation for which a capital expenditure allowance has been provided, it will only be in certain specific circumstances that entering into a network support service agreement could be considered a network support event. This reduces the number of possible eligible events.

Additionally in Victoria, DNSPs are more likely than TNSPs to enter into network support services agreements where these related to deferral of network-to-network connection asset augmentation. For these types of network support agreements, there will be little difference between the size of these projects for DNSPs and TNSPs. This implies identical cost recovery arrangements should apply.

6. Are there reasons why specific network support pass throughs should allow for transmission connection support service arrangements?

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This would only be a partial solution in Victoria. In Victoria, Figure 5.2 in the Consultation Paper does not hold. Instead, the embedded generator is providing the service to the DNSP, and receives the network support payment from the DNSP. As DNSPs are unable to recover network support payments through the exit service charge, there is no means to recover costs from the TNSP for arrangements that do not form part of the existing revenue determination.

In Victoria, a TNSP would not enter into a network support agreement with an embedded generator providing network support as an alternative to the augmentation of network-to-network connection assets as the TNSP is not responsible for providing this service.

The Consultation Paper states that:

‘...a reason for treating transmission connection assets differently from augmentations of the shared network may be that for a connection there is only a single counter-party. That party could itself contract with a non-network service provider to defer the need for a transmission connection asset (and therefore service). In contrast, the shared transmission network is used by everyone, and so it is necessary for the users to jointly appoint an agent (the TNSP) to procure non-network solutions on their behalf.’

Although there is only a single counter-party for network-network connection assets (being the DNSP), there are still many customers who will benefit from such an agreement, and in this case the DNSP can be considered the agent procuring non-network solutions on behalf of these customers. This should be passed on through connection charges.

SP AusNet notes that the Rule Change request was limited to network support payments as an alternative to augmenting network to network connection assets, rather than other types of connection asset.

7. Should DNSPs be able to recover costs for deferring transmission connection assets?

Yes. In Victoria DNSPs are responsible for planning transmission connection assets, therefore it is DNSPs rather than TNSPs that will enter network support arrangements for deferring transmission connection asset augmentation. Therefore they should be able to directly recover costs associated with these arrangements, such that they continue to bear the risk of this.

The Consultation Paper states that:

‘...the proponent’s proposal to extend [TNSP arrangements for network support payment recovery] to DNSPs as well could create a different basis in recovering costs under the network option versus the non-network option.’

However, the current Rules already have a different basis in recovering costs under the network option versus non-network option for transmission connection support in Victoria. This is following the March 2011 ‘DNSP Recovery of Transmission-Related Charges’ rule change, which specified that prescribed exit service charges (which in Victoria include

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traditional connection asset augmentations), while network support payments should be recovered through other means. Therefore, the rule change proposal would not be creating this different basis in recovering such costs under the network option versus non-network option, but rather, given this, would allow efficient cost recovery.

Victorian DNSPs are currently unable to recover costs for transmission support services mid-period. However, SP AusNet has identified opportunities to enter into network support agreements as an alternative to augmentation of transmission connection assets at a lower cost to customers. However, there is no incentive to enter into these agreements as while costs for network augmentations would be recouped through exit charges, the cost of network support as an alternative is unable to be recovered. Therefore, the incentive to pursue network augmentations, even where these are more expensive, persists.

8. Is this problem unique to Victoria? Should this be addressed through Victorian specific arrangements?

The ability to recover network support payments associated with augmentation of transmission connection assets is limited to the revenue determination in all NEM jurisdictions. Therefore, this is a NEM-wide problem. However, in Victoria amending the specific network support pass through afford to TNSPs will not resolve this, as uniquely it is the DNSP that is more likely to enter into these types of network support agreement.

The ability of DNSPs to recover costs associated with network support agreements is limited to the revenue determination in all NEM-jurisdictions. DNSPs are not afforded the same certainty to network support arrangements pass through as TNSPs (although acknowledge the AEMC has considered this in other contexts).

9. If a rule were to be made, when should the rule commence operation?

10. Are there any other transitional requirements that should apply to the rule change?

The questions above are answered assuming the proposed rule change is implemented as outlined in the Rule Change proposal.

To maximise the benefits associated with this Rule Change, the rule should commence operation as soon as possible. SP AusNet has identified an opportunity to enter into a network support arrangement, to allow network augmentation to be deferred. Once the inability to pass through costs has been addressed, SP AusNet will proceed with this arrangement, benefiting customers. In particular, the benefits of the rule change as proposed would be diminished if it were not to apply until the next regulatory reset for each NSP. This is because in any case at the determination NSPs would have the ability to propose network support expenditure (although this is less preferable than recovering costs through a pass through mechanism as described above, including lack of certainty for recovery of these costs across regulatory periods biasing decisions against non-network solutions). Therefore the additional benefit associated with the rule change would be smaller than if it was introduced straight away. However, the opex roll through would

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not need to apply until the start of the next regulatory period, but as this is only effective at the time of the regulatory determination; it makes no difference when it commences.

The impact on the required rate of return from investors is likely to be negligible, and far below the benefits of rule change if introduced immediately after the determination. This is because the quantum of expenditure this relates to is particularly low when compared to total expenditure. Therefore, potential future cost savings for customer from commencing the rule change as soon as possible is likely to outweigh any benefits of delaying.

11. Are there any relevant jurisdictional requirements that may be impacted by the rule change? If so, please specify which instrument and when the potential overlap or conflict arises.

The Victorian arrangements are addressed by the rule change proposal. The proposal addresses the regulatory barriers preventing investment in efficient network support where it relates to deferring the augmentation of a transmission connection asset in Victoria, while also having benefits across the whole NEM.