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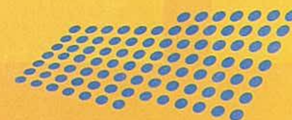

10 October 2008

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

Email to: submissions@aemc.gov.au

Dear Dr Tamblyn

Cost Allocation Arrangements for Transmission Services

The specific problems raised by the National Generators Forum in its Rule proposal are unlikely to be experienced in EnergyAustralia's network. However, the operation of Clause 11.6.11 and proposed changes outlined in the AEMC's Draft Determination has wider ramifications for all connections to a transmission network. We wish to ensure that changes outlined in the AEMC's Draft Determination will not adversely impact our network.

The Draft Determination raised broader concerns with the framework for Negotiated Services. We believe the complicated nature of this rule change is indicative of the confusion surrounding the application of negotiated services. We outline our experiences below. We also support the Commission's approach to ring fencing and would recommend a similar approach in respect of distribution.

Implications for Dual Function Assets

As you are aware, EnergyAustralia owns *dual function assets* which are established as part of our obligations as a Distribution Network Service Provider but which become part of the transmission system when they provide support to, and operate in parallel with, the higher voltage transmission network. Therefore some of our existing connections to the distribution network may be classified under the grandfathering provisions of 11.6.11, even though they were initially built to support the distribution network.

EnergyAustralia has assumed in these instances that a deemed connection exists between the transmission and distribution networks. This is so that customers who originally connected to the distribution network are not caught under provisions of a negotiated service upon reclassification of the network asset and subsequent replacement. Our approach is outlined in our regulatory proposal to the AER and is attached for reference.

EnergyAustralia would appreciate confirmation of this approach, or if the Commission does not agree with this interpretation, we request the AEMC consider amending the Rules so that dedicated connections to dual function assets that existed at 9 February 2006 are not unduly caught under negotiated services arrangements upon replacement. These assets are likely to have been established under the distribution capital contributions framework existing at the time. It would be inappropriate to apply a different regime to these assets upon replacement.

EnergyAustralia's experience with Negotiated Services

The complexities of the issues in the Rule change proposal highlight a more general problem with the classification of transmission services. The concept of negotiated transmission services, its application and regulation is not well understood by market participants. This creates significant regulatory uncertainty and difficulty when dealing with connecting parties. In EnergyAustralia's experience, applying these services to load connections in congested urban environments is unworkable in practice.

Negotiated services are delineated on the basis that they are either not shared or not "standard" services (for example, a service that provides above standard levels of redundancy). This delineation may be easily discernable on long radial networks but is problematic in meshed, urban environments. It is rare for network expansion (to connect customers) to remain dedicated to one customer over the life of the asset. Similarly above standard services are likely to be utilised by other customers within the shared network in the future.

EnergyAustralia is currently dealing with a situation where the status of certain assets hinges heavily on the timing of nearby network investments. If built today, the assets would form the negotiated service because their sole purpose would be to provide an above standard service to a customer. However, if built in 3 years time, the assets would be required by the shared network and therefore would deliver a standard service and thus be prescribed. Depending on load, the need for a "shared" network solution may be required in 5 years time, rather than in 3 years time. This has left the customer with a complex and confusing investment decision – whether to invest now in an above standard shared service under a negotiated arrangement or wait and hope for favourable load conditions and invest when the service would be prescribed.

In our experience, the Rules have not provided "...greater clarity regarding the type of transmission services that should be subject to a more intrusive form of regulation and those that should be subject to a less intrusive form of regulation.[1]" From an operations perspective, our network assets do not provide two different services. In our experience, our customers are interested in a cost reflective price, not two separate contractual arrangements for network supply arrangement.

The negotiated framework requires two sets of network prices to be calculated for the customer, one set for negotiated services and one set for prescribed services. If the negotiated service changes status in the future, consideration also needs to be given to the asset value at that time to determine the portion of the asset value that has been paid for by that customer and that therefore should be deducted from the asset value going in to the RAB.

From a financial perspective, it is difficult to calculate a price for the negotiated service (i.e. above standard system shared transmission service). The separate service does not allow for the risks of asset failure to be diversified across assets within the prescribed asset base. The costs of these risks must be fully allocated to the customer and will result in a higher overall cost to the market. The negotiated price must account for the future maintenance costs of assets which have a life of up to 45

[1] Draft Determination p22

years, the risk and consequent cost to EnergyAustralia of that asset failing prior to it reaching its standard life, and an appropriate allocation of overheads.

EnergyAustralia acknowledges the Commission's aim to ensure TUOS charges paid by consumers do not include the cost of services that did not contribute to the services provided by the shared network. We note however this can be done through more appropriate pricing and cost allocation arrangements, not necessarily by creation of a different service that is subject to a completely different form of regulation. We note as a result of this draft determination that sunk costs will not be reallocated to prescribed connection services, even where they no longer contribute to services provided by the shared network.

Capital Contribution arrangements for our distribution network ensure that shallow connection (and some deeper connection) costs are contributed up front by the connecting party. This ensures other customers do not contribute to the initial connection costs. In NSW any augmentation to the network that requires up front customer payment is contestable. This overcomes the Commission's concerns about overcrowding commercial options without complicating the regulatory framework.

Ring Fencing

EnergyAustralia supports the Commissions changes to ring fencing arrangements to ensure consistency with cost allocation principles. EnergyAustralia believes that a similar approach could apply to distribution.

Should you have any questions in relation to this submission please contact Ms Catherine O'Neill on (02) 9269 4171.

Yours sincerely

Trevor Armstrong
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