

# Draft connection charge guidelines for electricity retail customers

Response to the Australian Energy Regulator's draft  
guidelines and explanatory statement

February 2012

**ActewAGL** 

*for you*

## Introduction

ActewAGL Distribution welcomes the opportunity to respond to the Australian Energy Regulator's (AER's) *Draft connection charge guidelines for electricity retail customers* (the draft guidelines), released on 22 December 2011. ActewAGL Distribution, a partnership between ACTEW Distribution Ltd and Jemena Networks (ACT) Pty Ltd, owns and operates the electricity distribution network in the Australian Capital Territory.

In the draft guidelines and the accompanying explanatory statement the AER has clarified aspects of its intended approach and addressed several of the issues raised in response to the June 2011 consultation paper. However, ActewAGL Distribution has some remaining concerns with the AER's proposed approach:

- *Service classification and the guideline* – the application of the guidelines depends on how the connection services are classified by the AER. However, the AER has indicated that the classification of connection services is open to review, through the separate Framework and Approach review processes. This creates uncertainty for distribution network service providers (DNSPs) and network users.
- *Taking account of diverse circumstances* – the guidelines need to recognise the wide range of connection charging arrangements and situations currently and potentially in place across the national electricity market, as required by the Rules. ActewAGL Distribution is concerned that the AER is attempting to provide detailed prescriptions in the draft guidelines, and these will not provide the flexibility necessary to deal with diverse circumstances.
- *Estimating incremental costs* – the guidelines provide no guidance on what the “least cost technically acceptable standard” (used in calculating incremental cost) should be, nor guidance on how to resolve a disagreement over what standard is necessary. The requirement for a DNSP to offer to seek tenders on behalf of the customer should also be clarified, recognising the jurisdictional requirements that are in place.
- *Estimating incremental revenues* – the proposed mechanism whereby DNSPs provide the forecast of consumption and demand for each connection applicant and then provide refunds to the applicant after 3 years if the actual values are less than the forecasts involves an unreasonable shifting of risk to the DNSP and network users as well as a significant administrative burden, as new systems and processes must be established and implemented.
- *Pioneer scheme (refunds)* – ActewAGL Distribution accepts that the new chapter 5A of the National Electricity Rules requires the AER to include in its guideline a “pioneer scheme”. However, introducing the proposed scheme in the ACT where, for efficiency considerations, no such scheme currently exists, will involve

significant practical issues and implementation costs. The AER is adding to the burden of implementing such a scheme by applying an unreasonably low threshold of \$500.

These matters are discussed in the following sections.

## Classification of connection services

Under the draft guidelines, the methods to be applied in determining when a connection charge may apply and the amount of the charge depend on how the connection service is classified. For connection services classified as standard control services, the cost-revenue-test will compare the incremental cost attributable to the customer against the incremental revenue attributable to the customer for the relevant connection service. If the incremental cost is greater than the incremental revenue, then the customer will be required to meet the shortfall with a capital contribution payment. In contrast, connection services that are classified as alternative control services will be subject to the terms of the relevant distribution determination.<sup>1</sup> Currently the definitions and classifications of connection services vary widely across jurisdictions.

As part of the Framework and Approach process for the 2014-19 ACT and New South Wales distribution determinations, the AER has released a consultation paper on the classification of services. The AER has raised the option of changing the classification of at least some components of ActewAGL Distribution's connection services from standard control to alternative control.<sup>2</sup> In the explanatory statement released with the draft guidelines the AER has also indicated that it will be reviewing the classification of connection services for all jurisdictions.

The AER's decisions on the classification of services, particularly connection services, will have a critical impact on how the connection charges guideline will apply. However, the AER's final decision on the classifications for the ACT and New South Wales will not be known until 2014. In preparing its capex forecasts for the May 2013 regulatory proposal, ActewAGL Distribution will be uncertain about the classification of services, and hence the extent to which it may, under the new guidelines, seek capital contributions for network augmentations.

The transition to a new national regime for connection charges will involve considerable costs and challenges for DNSPs and network users, particularly where significant changes to charging arrangements will be required, as in the ACT. The costs and

---

<sup>1</sup> AER 2011, *Proposed connection charge guidelines: under chapter 5A of the National Electricity Rules, Explanatory statement*, p. 16

<sup>2</sup> AER 2011, *ACT and NSW service classification consultation paper* pp. 15-16

challenges are exacerbated by the uncertainty over how connection services will be classified and how the guideline will apply.

## Taking account of diversity

The current arrangements for connection charging vary widely across jurisdictions, as the AER's review in its explanatory statement indicate. The differences reflect a variety of historical, geographical and policy factors and planning requirements. ActewAGL Distribution considers that the national guidelines must be flexible enough to efficiently accommodate the differences, while at the same time providing some certainty for network service providers and users.

The need to take account of diverse circumstances is recognised in the Rules. In developing the guidelines, the AER must have regard to: historical and geographical differences between networks; inter-jurisdictional differences related to regulatory control mechanisms, classification of services and other relevant matters; and the circumstances in which connection services may be provided by persons other than DNSPs (and are therefore contestable).<sup>3</sup>

ActewAGL Distribution considers that while the AER has indicated an intention to take account of differences, its proposed approach in several places is overly prescriptive and emphasising uniformity and so will limit the flexibility of DNSPs to most efficiently meet the needs of customers.

For example, the AER has referred to allowing for differences in shared network augmentation charge rates in different areas. The AER says in the explanatory statement that allowing different unit rates to be applied will mean that: "shared network augmentation charges will be reflective of the actual shared network augmentation cost in each region, which will provide an efficient locational signal to new customers."

ActewAGL Distribution supports this broad approach. However, we note that in the draft guideline (clause 5.2.11) the AER lists the factors to be taken into account in calculating the "applicable unit rate". The only factors referred to are (i) the proportion of each network component used by the connection applicant and (ii) the useful life of the network component and the assumed period for which the applicant will be using the network. These do not properly take account of factors relevant to diverse circumstances. ActewAGL Distribution considers that there are other factors that the DNSP may reasonably take into account in determining the appropriate unit rate. Rather than trying to prescribe in the guideline how the unit rates should be calculated, the AER should allow the DNSP to propose a rate, taking account of the relevant historical, geographical

---

<sup>3</sup> AER 2011, *Explanatory statement*, p. 9

and other circumstances in relation to the connection and customer. These will then be subject to AER approval, under draft guideline clause 5.2.8.

## Estimating incremental cost

ActewAGL Distribution has two main concerns about the draft guidelines on calculating incremental cost. The first relates to the requirement, set out in clause 5.2.1(b) that the DNSP calculate the “charge for each component on the least cost technically acceptable standard necessary for the connection service”<sup>4</sup> (unless the applicant requests a connection service of a higher standard or the service involves augmentation of the shared network).

ActewAGL Distribution accepts that in principle the charge should relate to the least cost technically acceptable standard necessary for the connection. However, there are likely to be practical issues in determining this solution, and potentially disagreements between the DNSP and customer over what standard is necessary. The draft guidelines provide no guidance on how such issues should be resolved. Under the current requirements for the ACT, as set out in the *Electricity Network Capital Contribution Code 2007*, “basic standard infrastructure” is defined (in clause 3.2), and the DNSP has the discretion to choose the type of assets used, within the Code definition.

The second concern relates to the requirement to offer to seek tenders for customers. In response to the June consultation paper, ActewAGL Distribution opposed the AER’s proposed \$3000 threshold for requiring a tender, and also argued that for services that are not contestable it is not practical to require a tender process.

In the explanatory statement the AER says:

“The AER accepts that its preliminary position in relation to tenders may not have been workable. As such its preliminary position that all connection works greater than \$3000 must be tendered has been relaxed.”<sup>5</sup>

However, the AER then goes on to state:

“However, the AER considers that DNSPs should offer to tender work for customers when requested, as this provides comfort to customers that the construction work is being performed at an efficient price.”

---

<sup>4</sup> AER 2011, *Explanatory statement*, p. 12

<sup>5</sup> AER 2011, *Explanatory statement*, p. 31

The AER seems to narrow and clarify the requirement later in the explanatory statement (emphasis added):

“For negotiated connections under clause 5A.C.1 of the NER, a customer should be allowed to conduct a tender, **whenever jurisdictional rules allow**. Additionally, for these services DNSPs should offer to conduct a tender process on behalf of the customer to have the connection work provided by a qualified independent service provider.”<sup>6</sup>

However, the relevant clause in the draft guidelines (clause 5.2.3) involves a different requirement, which could be inconsistent with the AER’s intention as set out in the quote above from the explanatory statement. Instead of the tender requirement applying “whenever jurisdictional rules allow”, as in the explanatory statement, the guideline tender requirement relates to situations “if a distribution network service provider is able to use independent contractors”:

“If a distribution network service provider is able to use independent contractors to perform *connection services* work on its network, the distribution network service provider should offer to run a tender process on behalf of the *connection applicant* or allow a *connection applicant* to run a tender process, to procure the connection services.”

ActewAGL Distribution considers that the wording “if a distribution service provider is able to use independent contractors to perform connection services” is problematic and could result in a requirement that is inconsistent with jurisdictional requirements. Jurisdictional arrangements may require the DNSP to be the sole provider of certain connection services, but still allow the DNSP to engage independent contractors to most efficiently perform some of the connection services. In the ACT ActewAGL Distribution is the sole supplier of certain connection services to customers, but it engages independent contractors to efficiently perform some connection services work.<sup>7</sup> Giving the customer the option to seek its own tenders, or have the DNSP do so on its behalf, would be impractical and confusing as it would be inconsistent with a jurisdictional policy that the service not be contestable.

ActewAGL Distribution considers that the draft guidelines clause 5.2.3 should be clarified. The reference to the DNSP using independent contractors should be changed, and the clause re-worded to ensure it fits with the AER’s explanation that tenders should be offered when jurisdictional arrangements allow.

---

<sup>6</sup> AER 2011, *Explanatory statement*, p. 31

<sup>7</sup> See T. Quinlan, Statement to the Legislative Assembly for the ACT: 2004, Week 10 Hansard 26 August.

## Estimating incremental revenue

Forecasts of the connection applicant's consumption and demand are required in order to calculate incremental revenue (as part of the incremental cost-revenue-test). Clause 5.4.4 of the draft guidelines says that DNSPs' connection policies "must include" an approach where the DNSP may provide estimates, then review after 3 years and provide a refund, or apply an additional charge, if the actual values differ from the forecasts. The refund (or extra charge) will not apply if the connection applicant ceases to use the property or becomes insolvent. ActewAGL Distribution considers that this mechanism involves an unreasonable shifting of risk onto the DNSP and network users, as well as a significant administrative burden as new tracking systems and processes must be established. The DNSP should have flexibility to decide whether or not to include such a mechanism in its proposed connection policy.

In the explanatory statement the AER notes that the application to real estate developers is "less clear", and:

"If the approach was applied and the estimate was found to be inaccurate, it would not be equitable to levy an additional charge on the residents of the property—given the developer would have the benefit of the approach by paying a lower initial capital contribution."<sup>8</sup>

The AER says that DNSPs and real estate developers should be free to reach private agreement on the forecasts and how additional costs will be treated.

ActewAGL Distribution considers that there is no need to require a DNSP to include in its connection policy a complex system of setting consumption and demand forecasts then applying refunds or additional charges after 3 years. DNSPs and all applicants, not only real estate developers, should be free to reach a private agreement within an agreed regulatory framework.

## Pioneer scheme

Chapter 5A of the Rules requires the AER to include a pioneer scheme in its guidelines. The proposed pioneer scheme would involve refund of connection charges for a connection asset when an extension asset originally installed to connect the premises of a single retail customer is used, within seven years of its installation, to connect other premises and thus comes to be used for the benefit of two or more retail customers.<sup>9</sup> No

<sup>8</sup> AER 2011, *Explanatory statement*, p. 41

<sup>9</sup> AER 2011, *Explanatory statement*, p. 56

refund or pioneer scheme currently exists in the ACT, given ACT planning requirements and the focus on keeping costs as efficient as possible.

In response to the June 2011 consultation paper ActewAGL Distribution argued that a refund threshold of \$500 is too low in consideration of administrative costs. As the AER noted in the explanatory statement, one of the largest costs involved in the pioneer scheme would be to maintain a database of assets, and to check a new customer's connection against the information held in the database to determine whether the scheme is applicable.<sup>10</sup> ActewAGL Distribution also notes United Energy's comment that its scheme has not been applied often over the past 10 years and there are large costs of tracking details of thousands of connection assets. This is exactly the concern of ActewAGL Distribution, which has not seen merit in introducing such a scheme. The significant costs of setting up and implementing the scheme will need to be recovered from customers.

ActewAGL Distribution does not agree with the AER's draft decision to apply a threshold of \$500 for the pioneer scheme. A much higher threshold should be applied to justify the administrative burden associated with this process. Taking account of the total administrative time and labour rates to process an individual rebate, and the need to discourage inefficient processing of small claims, ActewAGL Distribution suggests a threshold of at least \$2000 for the pioneer scheme.

## Treatment of relocations and removals

Relocations and removals can be an integral part of a connection service, and for this reason they are covered by the current *ACT Electricity Network Capital Contribution Code 2007*. The AER's draft connection guidelines make no reference to relocations and removals. ActewAGL Distribution seeks confirmation on whether relocations and removals associated with connection services are to remain covered by jurisdictional arrangements.

---

<sup>10</sup> AER 2011, *Explanatory statement*, p. 58