Contact: Jeremy Inglis
Phone no: (03) 6237 3692
Our Ref: NW 30248251

16 February 2012

Mr. Chris Pattas
General Manager
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Attention: David Chan

Dear Mr Pattas,

Draft Connection Charge Guideline – Distribution Network Service Providers

Thank you for the opportunity to comment on the *Draft Connection Charge Guidelines for Electricity Retail Customers* (the Draft Guidelines) published by the Australian Energy Regulator (AER) in December 2011.

Aurora is keenly aware of the effect of rising electricity prices on its customers. To this end, Aurora has implemented a business-wide strategy to ensure that it provides its services to its customers at the lowest sustainable price. Aurora therefore welcomes any changes within the national electricity market that will lead to better and efficient outcomes for its customers.

In anticipation of the introduction of the National Energy Customer Framework (NECF) concurrently with the commencement of its first Regulatory Control Period under the AER, Aurora revised its Customer Capital Contributions Policy to align with the NECF principles foreshadowed in the second exposure draft of the NECF:

- that all customers generally pay for connection assets as an upfront contribution and contribute to the shared network through DUoS charges, and that only large customers contribute towards upstream augmentation costs.

Aurora observes, however, that the Connection Charge Principles articulated in the proposed clause 5A.E.1 significantly diverge from those in the second

Aurora Energy Pty Ltd
ABN 85 082 464 622
21 Kirksway Place
GPO Box 191
Hobart Tasmania 7001
www.auroraenergy.com.au

exposure Draft of the NECF. Since the AER is constrained to work within the framework provided by the NER, the AER's Draft Guidelines do not provide the protection for small customers that were first mooted under the NECF.

Aurora supports the intentions of the AER to develop a guideline that is equitable, promotes economic efficiency, clear price signalling, limits cross-subsidisation, avoids price shocks to customers, and recognises geographical and historical differences between customers. These were the broad principles of the NECF and are, on the whole, supported by the preliminary positions of the AER.

Aurora observes that the approach to the calculation of capital contributions in the Draft Guideline using a cost-revenue test moves more towards the requirements to protect the DNSP from a requirement to provide an uneconomic connection than to ensure that the costs for the connection of a new customer are not borne by other customers already connected to the network. In effect, the AER's application of the cost-revenue test relieves connecting customers from the real upfront cost of connecting, and requires all customers to make significant contributions to new connections through DUoS charges.

A consequence of this approach, as noted in Aurora's previous submission on the AER's consultation paper: Issues and AER's preliminary positions – connection charge guideline for accessing the electricity distribution network, which relies on DUoS for the recovery of the value of most connection assets, is an increase in the value of the Regulatory Asset Base, with a subsequent impact on electricity prices. Further, the key principles contained in Chapter 5A, clear price signalling and removal of cross subsidies, are not fully achieved under this approach.

More detailed comments regarding the Draft Guideline are contained in the attachment to this letter.

If you have any queries regarding any of Aurora's responses please contact Leigh Mayne at Leigh.Mayne@auroraenergy.com.au or Jeremy Inglis at Jeremy.Inglis@auroraenergy.com.au.

Yours sincerely

Fiona Calvert
Acting General Manager – Commercial, Regulation and Strategy

Attachment: Discussion of Points of the AER Connection Charge Guideline

AER's Proposed Connection Charge Formula

The Draft Guideline states that the connection charge that connection *applicants* will pay to the distribution network service provider (DNSP), may be made up of multiple connection services and will be calculated in accordance with the following formula:

Connection Charge = AS + CC + PS,

where,

- AS is the charge payable to the distribution network service provider for all alternative control connection services.
- CC is the capital contribution payable to the distribution network service provider for all standard control connection services. This is calculated with reference to the cost revenue test in section 5 of this guideline.
- PS is the total payable to the distribution network service provider, to account for any existing pioneer scheme, applying to the assets to which the customer connects.

Aurora considers that this approach is appropriate.

The Draft Guideline further states that CC is calculated using the following cost-revenue-test:

CC = ICCS + ICSN – IR(n=X),

where,

- CC = Capital Contribution;
- ICCS = Customer specific incremental costs incurred by the DNSP;
- ICSN = Incremental costs in the upstream (shared) network directly attributable to the new connection, where applicable; and
- IR(n=X) = Present value of a X year revenue stream directly attributable to the new connection.

Aurora agrees with the AER's preference of introducing a cost revenue test to cover all connections, and concurs with the AER's position that the customer should pay a capital contribution equal to the difference between the cost of connecting the customer and the incremental revenue to be collected as a result of the connection. Aurora considers the above formula is appropriate

to protect DNSPs from a requirement to effect non-economic connections, and provides a limited pricing signal to connecting customers.

This approach does not, however, provide the price signals to customers regarding the true cost of a connection, nor does it achieve the original intentions of the NECF to limit cross-subsidies. Under the approach implemented by the equation above, the whole of the cost of the connection that falls within the threshold set by the present value of the revenue stream will be funded as part of the DUoS charges which are recoverable from the customer base of the tariff.

Aurora observes that the approach articulated by the AER aligns with the approach that has existed historically in Tasmania. The addition of the value of customer connection assets to the RAB results in significant annual increases to the RAB value, with consequent increases in revenues and tariff. While, from a social perspective, it may be appropriate for society to bear the cost of connection of an individual, such an approach dilutes any pricing signals regarding the connection and also leads to increased prices for all customers within the same class. Aurora contends that this approach is out of step with current customer price expectations.

Aurora understands that the AER's formula takes into account when a small customer or micro-embedded generator is not required to explicitly pay for shared network augmentation (and where related to a standard control service) then only the DUoS charges attributable to extension and premises connection asset costs will be included in the cost revenue test. Aurora requests further information to demonstrate how this calculation will apply.

Incremental Revenue Calculation

In calculating the incremental revenue component of the cost-revenue test, the Draft Guideline Explanatory Statement notes that "only DUoS charges attributable to the extension and premises connection assets costs will be included in the cost-revenue test" (page 27), but implies throughout the rest of that document and the Draft Guideline that the tariff appropriate to the customer be used in this calculation.

Aurora notes that the tariff includes both components associated with operations and maintenance costs, which has been recognised by the AER, and shared network costs, which may not have been. In consequence, the tariff applicable to the connecting customer would need to be reduced by factors commensurate with the proportions of each component. Alternatively, the revenue stream from the building block approach under part C of chapter 6 of the National Electricity Rules can be applied using the value of the extension and premises connection assets in place of the RAB, with the annual revenue stream. The annual revenue stream from the incremental assets so calculated must then be treated to arrive at the DUoS charge relevant to the customer. For example, the annual revenue stream could be divided by the number of customers in the relevant customer class

to reach the DUoS charge appropriate to the customer. Aurora contends that this latter approach is more transparent and less prone to error than back-solving using existing tariffs.

Shared Network Augmentation Cost

Aurora supports the setting of a fixed demand threshold and the AER's approach in this regard.

Aurora agrees the DNSP should be responsible for setting the unit rate. Aurora suggests that a general per unit rate charge could be developed based on the existing methodology in South Australia.

Aurora agrees with the AER's revised position as reflected in the Draft Guideline to charge for shared network augmentation based on the customer's total peak demand if that customer is above the relevant shared network augmentation charge threshold. This will restore equity when applying the cost-revenue-test to customers above the threshold.

Aurora notes, however, that the protection of residential customers from a requirement to pay upstream augmentation costs, which was originally a foundation principle of the NECF, is no longer supported by the Draft Guideline.

Real Estate Developers

The Draft Guideline indicates that where constructing subdivisions is a standard control service, developers should be treated as a single customer for the purposes of calculating the required customer capital contribution and applying the AER's cost-revenue-test.

Aurora notes, however, that developers offer no load and, therefore, provide no incremental revenue to compensate the incremental costs of installing the infrastructure. In consequence, Aurora considers that building infrastructure to accommodate developers constitutes a pure asset construction task, and contends that developers should be charged the full cost of installing necessary infrastructure to support the development.

Aurora suggests that to be consistent with the remainder of the Draft Guideline, developers should be required to contribute towards "backbone infrastructure" only, with prospective connecting customers within the development charged for their connection assets. Also, consistent with the contention that developers offer no load is the proposal that developers should not be liable for the cost of upstream augmentation.

The AER's approach to real estate developers creates a number of challenges, such as estimating future customer load where the intended usage is unknown.

Should the AER pursue this approach, Aurora envisages that once the arrangements apply in Tasmania it would need to request a security fee equal to the full cost of the works to ensure that Aurora (and its customers) bears no risk from unutilised or underutilised assets. Aurora considers this would create an unnecessary administrative burden. Adopting the alternative approach of requiring only a capital contribution based upon a forecast provided by a developer with an interest in overstating expected load, construction of subdivisions will be heavily cross-subsidised by the wider customer base, which would be out of step with the original NECF principles.

Works Contestability

Aurora considers the AER's revised position to not prescribe arrangements for works contestability appropriate.

Prepayments

Aurora considers that no limits should be set on prepayments. Prepayments may be required to progress design and other matters as part of the application process. Construction should not commence until the full customer contribution has been received.

Disallowing a DNSP to request payment where commencement of construction is greater than three months away is workable but would appear an unnecessary administrative burden. A more appropriate solution is to allow the DNSP to negotiate the payment arrangements in good faith, should this situation arise.

Security Fee (financial guarantee) scheme

Aurora understands that the security fee scheme is intended to prevent otherwise risky projects from being effectively guaranteed by the rest of the customer base. This is already contemplated under Part K of Chapter 6 of the NER. A security fee scheme, provided it was in the form of an irrevocable bank guarantee, could be considered appropriate for the recovery of outstanding incremental costs associated with a customer connection.

In the absence of payments being collected upfront it would be important that DNSPs, and the broader customer base, are protected from any risky connections using a security fee scheme.

Aurora notes that the application of the cost-revenue-test to developers may result in numerous requests for security fees. Issues with developers are dealt with more fully under the section Real Estate Developers.

Refund of Connection Charges for Extension Assets

The Draft Guideline notes that a pioneer scheme could be applicable to real-estate developers.

Aurora disagrees with this approach. Since developers recover the upfront costs through the subsequent sale of vacant lots, there is no reason for subsequent customers to pay a second contribution.

Clause 6.1.2 of the Draft Guideline states that rebates accrued under pioneer scheme must be provided to the original customer who paid for the specific extension assets. Aurora suggests the rebate should be provided to the current 'occupier' since the property may change hands and the 'value' of the premise's connection to the electricity network would be capitalised into the re-sale value of the property.

Clause 6.1.4 of the Draft Guideline states that for the purpose of calculating the amount payable and refunded under the pioneer scheme, the depreciated value of the assets must be used. While Aurora supported this approach in its previous submission to the Consultation Paper, on reflection, Aurora considers there should not be any account for depreciation under the pioneer scheme. If the depreciated value of the assets is used, Aurora considers the original cost of assets should be escalated to not disadvantage the original customer.

Definitions

Aurora is satisfied with each of the definitions contained in the draft Guideline.

Protection of Residential Customers

The intention of NECF is to provide protection to small customers. Clause 5 of the National Energy Retail Law includes all residential customers in the definition of "small customer". The Draft Guidelines do not reflect this intention of the NECF, potentially requiring a high-usage residential customer to contribute towards upstream augmentation.