

27 April 2012

Mr David Chan
Director
Australian Energy Regulator
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Dear Mr Chan

CONNECTION CHARGE GUIDELINES: CONTESTABILITY

Thank you for your time and that of other AER staff for meeting with the NSW distribution businesses (DNSPs) and NSW jurisdictional representatives on 21 March 2012 to discuss the classification of services and connection charging under Chapter 5A.

As you know, in February 2012, the NSW Government released its second policy paper¹ addressing implementation of the National Energy Customer Framework in NSW. Among the implementation arrangements were arrangements for the retention of the contestability framework for distribution services in NSW. The paper stated:

*"The contestable framework that currently exists in NSW supports competition for network connection services in NSW. Network businesses are generally not responsible for works undertaken by ASPs. For this reason, contestable work will be excluded from the operation of Chapter 5A of the National Electricity Rules."*²

The *Electricity Supply (General) Regulation, 2001* ('Regulation') provides that where the provision of customer connection services to a customer requires an extension to the DNSP's distribution system or an increase in the capacity of the distribution system so as to enable it to provide customer connection services, and the DNSP requires a customer to contribute towards that cost, then the service is contestable.

Under section 25 of the *Electricity Supply Act, 1995* ('Act'), a DNSP may require a new customer to contribute towards the costs incurred or to be incurred by the DNSP in extending its distribution system, or in increasing the capacity of its distribution system, so as to enable it to provide customer connection services to the customer.

¹ NSW Government, "New South Wales Implementation: transitional arrangements, National Energy Customer Framework", February 2012

² p5

As such, the DNSP has the discretion to determine which connection services to the customer are contestable. In doing so, a DNSP must also comply with any determination of IPART relating to the proportion of contributions that may be required from customers³.

IPART Determination No1 2002, titled "*Capital Contribution and Repayments for Connections to Electricity Distribution Networks in New South Wales*" (the Capital Contributions Determination) establishes a framework for determining how much customers will be required to contribute towards the capital costs of connecting them to the electricity distribution network.

Under the Capital Contributions Determination, the DNSP may require that a new customer procure and fund connection works (other than high voltage works to service a multi-occupant development that is connected or to be connected to an urban area)⁴. A DNSP may also require a rural customer or a large load customer to procure and fund network augmentations⁵. In these circumstances, the connection works must be the economic optimum size required given the customer's connection capacity, other loads and the expected growth in other loads⁶.

Where a DNSP requires the installation of service lines or certain equipment necessary to provide a supply of electricity to the customer, and an augmentation is contemplated for the future provision of services to other customers, a shared augmentation may arise.

As a general rule, a customer will pay for the direct costs of establishing the connection up to a defined point of connection to the network. These direct costs are those involved in providing and installing the lines and equipment that are dedicated to that customer. The DNSP will pay for all other costs. Exceptions to this rule are customers in rural areas and large load customers. As well as paying connection costs, these customers may be required to contribute to the costs of upgrading network assets.

Where a new customer is required under the Capital Contributions Determination to procure and fund connection works or network augmentations specified by the DNSP, the new customer may do this by engaging either the DNSP or an ASP (at the new customer's option) to construct those works⁷. This reflects the treatment of contestable distribution services under the Act⁸ and the Regulation⁹.

The classification and pricing arrangements for distribution services are outlined in the National Electricity Rules (NER). Under transitional Chapter 6 of the NER, where a distribution service was determined by IPART in its pricing determination for 2004-09 to be an excluded service, that classification is deemed to continue to apply in the current regulatory control period¹⁰. Under this

³ Section 25(3) of the Electricity Supply Act, 1995

⁴ Schedule 1, clause 1(1)

⁵ Schedule 1, clause 3(2)

⁶ Schedule 1, clause 5

⁷ Schedule 1, clause 6

⁸ Section 31 of the Electricity Supply Act, 1995

⁹ Clause 40 and Schedule 3(4)

¹⁰ Clause 6.2.3B(b)

IPART determination, contestable works are excluded services¹¹. They were further classified by the AER as an unregulated distribution service¹².

Where a DNSP determines that a shared augmentation is contestable, the customer may choose and engage an ASP to provide the shared augmentation. The DNSP would have a financial arrangement with the customer to accommodate the marginal cost of the shared augmentation (being that part of the augmentation to be used for customers other than the connecting customer). In this instance, the DNSP would also provide certain monopoly services, including the provision of information to the ASP to allow design work to be undertaken, and the certification of design work undertaken by an ASP 3 to ensure that the safety or operation of the DNSPs distribution system is not compromised¹³.

Upon completion, the augmentation assets may be gifted by the customer to the DNSP. When this occurs, the assets are valued net of the customer's capital contributions.

Chapter 5A

The proposed amendments to Chapter 6 include the insertion of a new Part DA relating to connection policies. Under clause 6.7A.1, a DNSP must prepare a proposed connection policy setting out the circumstances in which it may require a retail customer or real estate developer to pay a connection charge, for the provision of a connection service under Chapter 5A.

In February 2012, the NSW government released a policy paper stating that contestable works will be excluded from the operation of Chapter 5A¹⁴, (including the connection charge guidelines). However, in preparation for their next distribution regulatory proposal, DNSPs will be required to prepare connection policies for AER approval under proposed changes to clauses 6.12.1 and 6.12.3 of the NER. These connection policies will include references to contestable works and the payment of capital contributions.

Under proposed clause 6.7A.1(b), the connection policy must be consistent with the connection charge principles and the connection charge guidelines.

Guidelines

Clause 5A.E.3(b) provides that the purpose of the Connection Charge Guidelines (Guidelines) developed and published by the AER is to ensure that connection charges are:

- reasonable;
- provide, without undue administrative cost, a user pays signal to reflect the efficient cost of providing the connection services;
- limit cross-subsidisation; and

¹¹ IPART, NSW Electricity Distribution Pricing 2004/05 to 2008/09, Final Determination, June 2004,p3

¹² AER, Final Decision, NSW Distribution Determination 2009-10 to 2013-14, 28 April 2009, p30

¹³ IPART , NSW Electricity Distribution Pricing 2004/05 to 2008/09, Final Determination, June 2004,p47

¹⁴ NSW Government, "New South Wales Implementation: transitional arrangements, National Energy Customer Framework", February 2012, p5

- be competitively neutral.

In particular, clause 5A.E.3 (b)(4) provides that the purpose of the guidelines is to ensure that *connection charges* if the *connection services* are *contestable*, are competitively neutral.

Clause 5A.E.3 (e)(3) further provides that in developing the guidelines, the AER must have regard to the circumstances in which *connection services* may be provided by persons other than *Distribution Network Service Providers* (and are therefore *contestable*).

In NSW, the contestability regime for the provision of connection services has been in place since 1995. It has operated successfully, providing timely and cost effective delivery of services to connection customers and benefiting the broader economy. The NSW legislative framework for the provision of contestable works has ensured that they are reasonable, provide a user pays signal to reflect the efficient costs of providing the connection services (being the market price), limit cross-subsidies and are competitively neutral.

Where shared augmentations are provided through contestable works, they can clearly be demonstrated to meet the purpose of the Guidelines. Moreover, the long term interests of customers are served by the efficient investment in, and use of, shared augmentations provided through a contestable framework. This is acknowledged in the current Capital Contributions Determination which specifies that the connecting customer's connection capacity, other loads and the expected growth in other loads be taken into account in determining the economic optimum size of connection works.

The AER has stated that it considers contestable frameworks can be maintained, or promoted, by applying an appropriate service classification in each jurisdiction.

Classifying a shared network augmentation provided by the contestability framework in NSW as unclassified would maintain competitive neutrality whilst allowing the customer to only pay for its share of the augmentation triggered, based on its usage of the required assets.

While the marginal increase in the amount paid by a DNSP for that part of the shared augmentation attributable to customers other than the connecting customer, may be classified as a standard control service, the delivery of the connection services through contestable works would ensure that competitive neutrality and the other purposes of the Guidelines are met. On this basis it would be reasonable to effectively classify these works as 'unclassified' for the purposes of the Guidelines.

NSW DNSPs note that service classifications and forms of control are decided in the distribution price control determination process. However, a decision of the AER to include shared augmentations (funded by both a DNSP and a connecting customer) provided through a contestable framework as unclassified connection services for the purposes of the Guideline, whilst recognising the value of the shared augmentation net of capital contributions paid by the connecting customer would facilitate ongoing jurisdictional requirements for contestability and promote the long term interests of customers.

If you have any questions relating to this submission, please contact Mr Erik Beerden, Regulatory Affairs Manager, on telephone number (02) 9853 6904.

A handwritten signature in dark ink, appearing to read 'Frank Nevill', written in a cursive style.

Frank Nevill
Acting Manager Network Regulation