FINAL DECISION

Ergon Energy
Distribution Determination
2020 to 2025

Attachment 17
Connection policy

June 2020

AUSTRALIAN
ENERGY
REGULATOR

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Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to Ergon Energy for the 2020–25 regulatory control period. It should be read with all other parts of the final decision.

The final decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 12 – Classification of services

Attachment 13 – Control mechanisms

Attachment 14 – Pass through events

Attachment 15 – Alternative control services

Attachment 17 – Connection policy

Attachment 18 – Tariff structure statement

Attachment A – Negotiating framework

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17 Connection policy

We are required to make a decision on the connection policy that is to apply to Ergon Energy for the 2020–25 regulatory control period. This may be the connection policy prepared by a distributor, some variant of it, or a policy substituted by the AER.[1]

A connection policy sets out the nature of connection services offered by a distributor, when connection charges may be payable by retail customers and how those charges are calculated. It also:

- must be consistent with:[2]
    - the connection charge principles set out in chapter 5A of the National Electricity Rules (NER)
    - the connection policy requirements set out in part DA of chapter 6 of the NER
    - our connection charge guidelines published under chapter 5A,[3] and
- must specify:[4]
    - the categories of persons that may be required to pay a connection charge and the circumstances in which such a requirement may be imposed
    - the aspects of a connection service for which a connection charge may be made
    - the basis on which connection charges are determined
    - the manner in which connection charges are to be paid (or equivalent consideration is to be given)
    - a threshold (based on capacity or any other measure identified in the connection charge guidelines) below which a retail customer (not being a non-registered embedded generator or real estate developer) will not be liable for a connection charge for an augmentation other than an extension.

The AER's connection charge guidelines for electricity retail customers

A connection policy must be consistent with our connection charge guidelines for electricity retail customers. The purpose of our Guideline is to ensure that connection charges:[5]

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1 NER, cl 6.12.1(21).

2 NER, cl 6.7A.1(b)(1).

3 AER, *Connection charge guideline for electricity retail customers, Under chapter 5A of the National Electricity Rules Version 1.0*, June 2012.

4 NER, cl 6.7A.1(b)(2).

5 NER, cl 5A.E.3(b); AER, *Connection charge guideline for electricity retail customers, Under chapter 5A of the National Electricity Rules Version 1.0*, June 2012, p. 11.

- are reasonable, taking into account the efficient costs of providing the connection services arising from the new connection or connection alteration
- provide, without undue administrative cost, a user-pays signal to reflect the efficient costs of providing the connection services
- limit cross-subsidisation of connection costs between different classes (or subclasses) of retail customers
- are competitively neutral, if the connection services are contestable.

17.1 Final decision

We do not approve Ergon Energy's revised connection policy because its proposed upstream shared network augmentation rates are not consistent with:

- the connection charge principles in chapter 5A of the NER, and
- our connection charge guidelines for electricity retail customers under chapter 5A.

We maintain our draft decision on Ergon Energy's connection policy. In our draft decision, we amended Ergon Energy's proposed connection policy to the extent necessary to enable it to be approved in accordance with the NER.[6]

The approved amended connection policy for Ergon Energy's 2020–25 regulatory control period is appended to attachment 17 of our draft decision.

17.2 Ergon Energy’s revised proposal

Ergon Energy accepted our draft decision that upstream shared network augmentation unit rates should be expressed in 'dollars per kVA' in accordance with the AER connection charge guidelines,[7] instead of 'dollars per kVA per annum' as originally proposed by Ergon Energy.

However, Ergon Energy did not accept our draft decision that its upstream shared network augmentation unit rates should be set at the same level as those for Energex. Ergon Energy argued that it did not believe using its original proposed charge rates:

- would be inconsistent with NER principles, or
- result in an unfair allocation of costs to new customers and cross-subsidisation between new and existing customers.

Ergon Energy explained that:[8]

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6 NER cl 6.12.3(j)(2) provides that we may amend the proposed connection policy to the extent necessary to enable it to be approved in accordance with the NER.

7 AER, *Connection charge guideline for electricity retail customers, Under chapter 5A of the National Electricity Rules Version 1.0*, June 2012.

8 Ergon Energy, *Ergon Energy Revised Regulatory Proposal 2020–25*, December 2019, pp. 56-58.

- The Queensland Government's Uniform Tariff Policy (UTP), while influencing the price that customers in the Ergon Energy distribution area pay for their electricity, is separate and distinct from the setting and recovery of network charges by Ergon Energy. While the notified retail prices for some customers (in regional Queensland) are constructed using the Energex network charges, Ergon Energy recovers the full Ergon Energy network charges from the retail business.
- Ergon Energy does not take UTP into consideration when undertaking the cost-revenue test to determine if a capital contribution will apply for network connection service. The Ergon Energy network charges are used when calculating the incremental revenue component of the cost-revenue test, not the substituted network charges used by the Queensland Competition Authority to calculate the notified retail prices. Ergon Energy considers that it is important that the unit rates should reflect the true costs of augmentation works to send appropriate signals to customers about the costs of providing connection services.
- The vast majority of small regional Queensland customers will fall below the threshold for the shared network augmentation charge, and therefore will not be required to pay a capital contribution towards the cost of network augmentation.

17.3 Assessment approach

Consistent with our approach in assessing Ergon Energy's connection policy in the draft decision, we examined the proposed changes to the connection policy against the requirements of clause 6.7A.1 of the NER as stated above—whether it:

- is consistent with the connection charge principles set out in chapter 5A of the NER and our connection charge guidelines, and
- contains all the information that must be specified under clause 6.7A.1(b)(2) of the NER.

17.4 Reasons for final decision

Our decision relates to the upstream shared network charge (also known as deep system augmentation charge). This charge relates to the cost for providing distribution network assets upstream from the point of connection. For low voltage connection of a typical house, the cost elements would include the distribution substation, high voltage network, sub-transmission network and the power transformer connecting to the transmission network. The upstream charge functions as a capital contribution from the customer connecting to the network that offsets the distributor's regulatory asset base (RAB).

Prior to Ergon Energy’s proposal, most distributors, including Ergon Energy, have not been charging for the full recovery of upstream costs. Some distributors are now beginning to increase charges to be more reflective of the long run marginal cost of supply. For example, SA Power Networks has proposed an 11 per cent increase to its previous charge rate for low voltage connection over the 2020–25 regulatory control period.

White we are open to greater cost-reflectivity in distributors' connection charges, we note that Ergon Energy proposed to set its upstream charge at the full long run marginal cost rate. This approach would result in upstream charge rates that are more than three times higher than existing rates. This will result in unreasonable price shock for new customers. Our proposed rates, however, represent a 22 and 9 per cent increase for residential and non-residential customers, respectively, which are a reasonable step change.

In assessing Ergon Energy's proposal, we have had regard to rule 5A.E.3 of the NER, which specifies that connection charges should aim to avoid unreasonable cross-subsidisation between classes of customers.

If new customers are to pay for the full long run marginal cost as proposed by Ergon Energy, this means that they will be paying for the full cost of the upstream network in advance. This up-front payment is a capital contribution that reduces the RAB. If new customers are paying a higher capital contribution than existing customers who did not previously pay the full upstream rates, and the costs of RAB are recovered from all customers, this will effectively result in new customers subsidising existing customers in the long run.

This factor, in combination with the price shock that would result in immediately transitioning to charges based on full long run marginal cost, is the reason why we do not accept Ergon Energy's revised proposal.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
distributor	distribution network service provider
NEL	National Electricity Law
NER	National Electricity Rules
RAB	regulatory asset base