



Major Energy Users Inc.

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Mr Chris Pattas
General Manager
Australian Energy Regulator
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By email: aer inquiry@aer.gov.au

Dear Mr Pattas

Connection charge guidelines

The MEU notes that the AER has released its draft guideline for Connection Charges to be paid to DNSPs for new connections to the distribution network. The Major Energy Users (MEU) sees the necessity for change from the existing approaches used and was pleased that the issue was addressed by the MEC and the AER as past practices incorporated a number of features that provided a disadvantage to consumers.

The current approaches tended to be based on the practices initiated when electricity supply arrangements were essentially vertically integrated government owned entities and in the disaggregation into the current market structure, the distribution network service providers (DNSPs) tended to retain these historic approaches, but without recognizing that there were now a number of key aspects of the new market structure that needed to be reflected in DNSP approaches to connections to ensure the most efficient outcome would be achieved.

Unfortunately, despite the opportunity provided to the AER to ensure that the new connection arrangements were reflective of the new market structure, the AER has opted not to make significant change to improve the way new connections are implemented. Essentially the draft guideline issued retains much of the approaches inherited from the old government owned vertically integrated supply businesses.

There are four glaring shortcomings in the AER draft guideline.

1. Competitive neutrality has been excluded
2. There is a lack of equity for both consumer and generator "first movers"
3. Locational signaling has been overlooked
4. DNSPs can profit from new connections.

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Competitive neutrality

The concept of competitive neutrality (for competitive elements of the market) is a key guiding aspect of the market structure that has been implemented. The draft connection guideline requires embedded generators to pay deep connection costs, yet large generators connecting to the transmission networks pay only shallow connection costs.

The issue of congestion in the transmission network is currently under review by the AEMC in its Transmission Frameworks Review and a final landing is still to be reached in regard to how congestion can be managed. The AER has determined that there will be no congestion and that embedded generators will have to pay deep connection costs to ensure that there is no congestion.

The AER draft decision discriminates between a generator connecting to the distribution network and one connecting to the transmission network.

Equity

The concept of equity in the market structure is effectively an outcome of the approach to maximise cost reflectivity. The achievement of cost reflectivity is to a degree counterbalanced by the need to minimize transactional costs. That is, there is a need for ensuring the transactional costs do not exceed the benefits that come from cost reflectivity. The draft decision fails the equity test on two counts.

Firstly, above a certain threshold, the “first mover” for a new consumer connection is required to pay all of the net costs of a new connection. For a limited time, any additional consumer connection to this new asset pays a share of the cost, but on a level that reduces over time. The “first mover” takes all the risk and may get some compensation as others used the assets paid for by the first mover. The AER has then arbitrarily decided that after a set period (15 years for a business and 30 years for a residential consumer) all rights are removed and the assets are deemed to be owned by the DNSP. There are no firm rights of access included in the payment for the connection.

Secondly, in the case of an embedded generator, it is required to pay deep connection costs but it has no rights of firm access into the network. Should there be congestion, the embedded generator can be required to cease generating, even though it has paid for relieving congestion through its deep connection cost.

The AER draft decision removes the rights of access that should come with payment for a connection.

Locational signals

The National Electricity Objective (NEO) is written with the long term interests of consumers as its focus. How this is to be achieved, according to the second reading speeches, is by maximizing efficiency of the electricity market.

In its development of the Chapter 6A rules, the AEMC clarified achievement of efficiency in networks by ensuring that there would be locational signals so that generators and consumers would connect to the networks where there was adequate spare capacity rather than connecting where new augmentations would be required to accommodate the new connection.

The draft decision has determined that wherever a new connection joins the network, the cost of the new connection should include for the replacement of the spare capacity used as a result of the new connection. This means there is no signal to a new connection to join where there is spare capacity. In the absence of a locational signal, the network usage will not be optimized and there will be no improvement in efficiency, and this will be a cost to all other users of the network.

DNSP profiting from new connections

The draft decision considers that that there should be no negative connection costs.

Under a revenue cap approach, such an approach would reflect that any over-recovery in one year will be offset by a reduction in the next year. On this basis the difference between the cost for a new connection and the amount received from the connector will be shared across all connected to the network the following year.

However, most DNSPs operate on a price cap basis, and they retain the benefits of any negative connection cost. The principle behind the price cap approach was that it would incentivise the DNSP to increase its usage of the network and thereby provide a benefit to all those using it. This outmoded concept displays two failings.

Firstly, there is a general recognition that there needs to be increased efficiency of usage of electricity as this reduces consumption of electricity and therefore lower greenhouse gas emissions. To incentivise a DNSP to increase consumption of electricity runs counter to all of the other legislation enacted to drive reduced consumption.

Secondly, it is recognized that DNSPs do not create new connections – they arise from outside the DNSP control. To incentivise a DNSP to create new connections just can't work as they don't drive the need.

In a revenue reset, the AER provides an allowance for the provision of new connections and augmentation of the networks. This is a cost which is effectively socialized across all users of the network. To add to the ability of the network to charge a new connector for deep connection costs and augmentation to relieve potential congestion provides the DNSP an ability to profit by not using the allowed capex provided at a reset for augmentation but to levy costs on new connectors and allowing for profiting from unused capex.

The MEU view

The MEU agrees that shallow connection costs should be recovered from those seeking connection. These costs should be offset against the increased revenue that will come from the new connector contributing to the network as a whole through paying the DUoS charges applicable for its class of usage.

It does not agree with the AER that deep connection costs should be levied on the new connections as this provides the DNSP with an ability to seek double revenue – from the new connector and from the revenue reset process.

A “first mover” which pays for the shallow connection should be provided reimbursement for its contribution over the life of the assets it funds, and it should not be exposed to the loss of its firm rights to the share of the usage of the assets its funds.

The MEU notes that it provided the only submission on this issue from an end user perspective regarding distribution connection arrangements, yet almost every connection to the distribution network is from an end user of electricity. It concerns the MEU that the AER has not addressed the four fundamental aspects of the structure of the electricity market noted above and has elected to essentially follow historic practice in developing its approach to connection charges

Yours sincerely

A handwritten signature in black ink, appearing to read "DSI Headberg". The signature is fluid and cursive, with a checkmark-like flourish at the end.

Public Officer