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October 2012

John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce 

Submission on Second Interim Report – Transmission Frameworks Review

Please find attached the Australian Energy Regulator's (AER) submission regarding the Australian Energy Market Commission's (AEMC) second interim report for the Transmission Frameworks Review.

The AER welcomes the opportunity to comment on these substantial proposed reforms to the energy market framework.

The AER would be pleased to provide further assistance to the Commission on this important area of work. If you would like to discuss any aspect of this submission please contact Tom Leuner, General Manager, Wholesale Markets, on (03) 9290 1890.

Yours sincerely



Ed Willett
Acting Chair
Australian Energy Regulator



AER Submission
Transmission Frameworks Review
Second Interim Report

October 2012

Contents

1	Summary	1
2	Transmission planning and pricing	2
2.1	Proposed enhancements to AEMO's NTP role.....	2
2.2	Fully centralised national independent planner model.....	3
2.3	NEM-wide transmission pricing.....	4
2.4	Aligning TNSP resets	4
3	Optional Firm Access Model	6
3.1	Incentives on TNSPs to meet the firm access standard	7
3.2	Access charges	7
3.3	Transitional arrangements	8
3.4	Dealing with disorderly bidding as matter of priority	9
3.5	Treatment of interconnectors	9
3.6	Integrating demand management solutions.....	10
3.7	Interaction with revenue determination	10
4	Connections	11
4.1	Strengthening connection applicants' negotiating position	11
4.2	Exemptions from obligation to register as a TNSP	12

1 Summary

The AER welcomes the opportunity to respond to the AEMC's Transmission Frameworks Review Second Interim Report. This submission sets out the AER's views in relation to:

- transmission planning and pricing
- the optional firm access (**OFA**) model
- connections

Planning

While the AER supports the proposed AEMC's proposals for extending AEMO's National Transmission Planner (**NTP**) role, the impact of these proposals appear to be limited in practice since Australian Energy Market Operator (**AEMO**) already undertakes most of the functions contemplated in the second interim report. The AER supports an extension of these functions beyond current levels by, for example, requiring AEMO to prepare demand forecasts at a connection point level, giving AEMO a formal role in the revenue determination process, and potentially having AEMO undertake certain regulatory investment tests for transmission (**RIT-Ts**).

With respect to transmission pricing, the AER considers that the AEMC's proposal for a NEM-wide transmission pricing scheme has significant advantages in terms of cost reflectivity, consistency and promoting efficient inter-regional investments. However, there are a number of potential issues. The AER is of the view that it is necessary to understand whether the scheme can be made to work in a manner that is both transparent and robust before forming a view on whether the benefits outweigh the costs.

Optional firm access

The AER welcomes the AEMC's work to develop the OFA model. The AEMC's proposed model is a fundamental change to the market which seeks to address a wide range of issues. It is likely that the full reforms would take a long time to implement.

The AER believes that, given the pressing issues associated with disorderly bidding and counter-price inter-regional flows, a simplified congestion management mechanism should be implemented in the short term. This mechanism could be introduced via relatively straightforward changes to AEMO's settlement systems, and may act as a stepping stone to the wider reforms being considered.

Connections

The AEMC's proposals in relation to connections represent an improvement on the status quo. However, while the connection applicant's negotiating position is stronger, they are still negotiating with a monopoly. The AER believes that further benefits would have been achievable if the AEMC had gone further in attempting to introduce competition to the connections framework.

Further, the AER has reservations about the proposed regulatory framework to apply to network extensions that are built by a party other than the local transmission network service provider (**TNSP**). The AEMC should consider variations on a build-own-transfer model.

2 Transmission planning and pricing

This section of the submission addresses the following issues:

- proposed extensions of the role of AEMO as the NTP in certain respects
- the possible move towards a fully centralised independent planning model
- the proposed market-wide transmission pricing regime to be regulated by the AER and administered by AEMO
- possible alignment of TNSP resets.

2.1 Proposed enhancements to AEMO's NTP role

The AEMC proposes to enhance the planning arrangements through measures which are designed to improve coordination between TNSPs and the NTP. These measures include AEMO:

- reviewing TNSP annual planning reports and RIT-T documents
- supplying demand forecasts to be used by TNSPs
- providing an expert independent advisory role
- holding the last resort planning power.

The AER supports these enhancements. However, their impact appears to be limited in practice since AEMO has begun to undertake most of these functions already.

The AER believes that there would be greater industry benefits if AEMO were to have expanded roles beyond those suggested by the AEMC. AEMO will be able to bring a national and market-based focus. The AER has concerns about incentives on TNSPs to build assets to greater than the efficient level and disincentives on TNSPs to consider alternatives to capital investment. Giving greater roles to an independent body, such as AEMO, would assist in addressing the AER's concerns.

In particular, the AER would support measures which would empower AEMO to:

- **provide an independent review of TNSP revenue proposals** as part of the regulatory determination process. Given its technical expertise, AEMO could provide a valuable supplement to the AER's review by taking a more active role in assessing the efficiency and prudence of TNSPs' expenditure. For instance, AEMO could provide advice on the extent to which proposed investments could more efficiently be met by operational changes or network support arrangements etc.
- **prepare independent demand forecasts at a finer level of granularity than at present.** AEMO already prepares an independent demand forecast at a regional level. However, TNSPs argue that distribution-to-transmission connection point specific forecasts are more relevant to their investment planning decisions, and continue to rely on forecasts developed by DNSPs. If AEMO were to develop connection point specific forecasts, the AER would have access to an independent demand forecast for the purpose of assessing TNSP expenditure forecasts. We note that AEMO will need more information from DNSPs and TNSPs to prepare these more detailed demand forecasts and is currently in the process of working through this.

- **contribute to the development of RIT-Ts.** The AER welcomes the AEMC’s proposal to give AEMO a formal role in reviewing RIT-Ts. However, the AER would support the AEMC considering a further strengthening of this function. For example, AEMO could have a more determinative role in approving or rejecting RIT-T assessments. In addition or instead, AEMO could actually undertake the RIT-Ts itself. One option might be for AEMO to undertake only the more significant RIT-Ts (i.e. above a certain cost threshold or RIT-Ts that relate to the national flow paths) in the first few years, with the role expanding to smaller RIT-Ts over time. AEMO should also be undertaking the RIT-Ts for inter-regional projects.
- **gather information from TNSPs as required to carry out its functions.** At present, AEMO is dependent on co-operation from TNSPs in order to carry out its functions. AEMO should have access to the information it requires so that it can exercise its discretion independently. This could involve imposing obligations on TNSPs to provide certain information to AEMO, which would be enforced by the AER, or conferring additional information gathering powers on AEMO.
- **undertake last resort *procurer* functions as well as last resort *planning* functions.** At present, the powers of the last resort planner are limited since they cannot compel a TNSP to undertake an investment. The AER supports strengthening this function so that the last resort planner may also undertake a competitive procurement process in the event that a TNSP is unwilling or unable to carry out a necessary investment (for instance, as a result of capital constraints).

These additional measures could represent a stepping stone towards a fully centralised national independent planner model, whereby an independent national transmission planning body undertakes all transmission planning instead of the TNSPs (see discussion below). However, it is also possible that these measures in themselves could reduce information asymmetry and increase the level of independent oversight of planning decisions to the extent that the AER’s concerns about incentives for over investment are addressed.

2.2 Fully centralised national independent planner-procurer model

The AER sees both benefits and costs in AEMO’s suggestion of moving to a fully centralised national independent planner-procurer model, whereby AEMO undertakes transmission planning and procurement instead of the TNSPs. There are potential benefits in terms of addressing the incentives on TNSPs to overstate their capex forecasts and favour investment solutions over cheaper operational or non-network solutions. There are also possible costs, in particular in relation to separating the investment decision making process from the TNSPs, which have responsibility for operating the network.

The AER notes that establishing an independent national planning-procurement body would represent a major shift from the status quo. The AER considers that the model should be considered further, with investigation of arrangements overseas to draw upon experience in other markets. On balance, the AER’s view is that, *at this stage*, more time should be given to assess the effectiveness of the existing National Transmission Planner model, subject to the enhancements proposed by the AER above.

The AER notes that it has been suggested that the AER does not support a move towards a centralised national independent planner because of a lack of checks and balances. This statement does not reflect the AER’s position. The AER considers that if there was a move to a centralised national independent planner, there are a range of governance arrangements and other mechanisms

that could be relatively easily introduced to improve accountability and transparency, which would address any concerns the AER had.

2.3 NEM-wide transmission pricing

The AEMC proposes the introduction of a market-wide transmission pricing scheme to give effect to consistent pricing signals across the NEM. These arrangements would be regulated by the AER and administered by AEMO.

The AER considers that the AEMC's proposed scheme has significant advantages in terms of cost reflectivity, consistency and promoting efficient inter-regional investments.

However it is not clear how a NEM-wide pricing methodology would interact with TNSP-specific revenue determinations. The model is also likely to result in significant price differentials for transmission customers within a jurisdiction, which may give rise to equity concerns. At the extreme, if the costs associated with a major transmission upgrade were directed solely toward customers located in a particular area, the impact on those customers could be substantial.

Finally, the model gives rise to governance issues which require careful consideration. TNSPs would no longer control whether they over or under recover, which would increase their exposure to risk.

The AEMC has proposed two options for the governance of the transmission pricing scheme: (1) require AEMO to administer the pricing methodology subject to AER approval; (2) hard-wiring the pricing methodology into the NER. The first option gives rise to questions of accountability in the event that prices are set incorrectly. The second option would be less flexible and carries the risk that TNSPs might be obliged to accrue significant over or under recoveries before problems associated with the pricing methodology are resolved.

The AEMC is yet to develop detailed proposals on how the market-wide transmission pricing scheme would work. The AER is of the view that it is necessary to understand whether the scheme can be made to work in a manner that is both transparent and robust before forming a view on whether the benefits outweigh the costs.

2.4 Aligning TNSP resets

The AEMC expresses in principle support for aligned TNSP resets on grounds that it would allow the AER to assess TNSP proposals in a holistic manner, reflecting investment options that are most efficient on a NEM-wide basis. The AER agrees. Aligned transmission resets will provide benefits in terms of transmission planning and also make it easier to invest in interconnectors.

The AEMC's discussion paper on transitional arrangements for the network regulation rule change recognises that given the new lengthened regulatory process timelines in the AEMC's draft Chapter 6 and 6A rules, the AER may, if given appropriate flexibility, seek to optimise the alignment of the reset schedule. In this regard, the AEMC proposes a transitional rule that would allow the AER, with the agreement of the NSP, to set a regulatory control period that is shorter than the existing five year minimum. The AER welcomes consideration of these transitional arrangements.

Equally, the AER notes that if the alignment of TNSP resets were to be pursued, the rules would need to provide sufficient flexibility for the AER to set shortened (and lengthened) regulatory control periods. This would not only allow for the potential alignment of TNSP resets, but could also be used to deal with consequential impacts on the reset schedule more generally. Avoiding congestion in the

reset schedule would be a key consideration as this would be difficult to manage for the AER and NSPs, and may inhibit the participation of consumers in the process.

3 Optional Firm Access Model

The AER welcomes the AEMC's work to develop the optional firm access (OFA) model. It aims to address a range of important issues, including:

- giving generators greater financial certainty (i.e. making their output and revenue less subject to network congestion and disorderly bidding), in order to reduce risk and improve contract market liquidity
- having generators pay for some transmission investment, rather than planners anticipating generator market development and customers paying for all transmission
- introducing stronger locational signals for generators
- increasing the firmness of interconnector availability, in order to improve energy contract liquidity and competition.

While the AEMC has made significant progress, there are many important areas of detail that are yet to be developed. The model entails a large amount of further work to develop, among other things, the firm access standard, access pricing methodologies, the procurement processes, the pricing methodologies and the TNSP incentive scheme. The success of the model will, in part, lie in the detail.

This section of the submission focuses on various aspects of the AEMC's optional firm access (**OFA**) model. The main issues discussed are:

- incentives on TNSPs to meet the firm access standard
- access charges and the potential for consumers to fund inefficient investment
- transitional arrangements and barriers to entry
- the need to deal with disorderly bidding as a matter of priority and prior to the implementation of the full OFA model
- treatment of interconnectors
- integrating demand management solutions
- interaction with revenue determination

As the AEMC is tackling a range of very complex issues, it is likely that any reforms will take a long time to implement. Therefore, the AER strongly believes that, given the significant and pressing issues associated with disorderly bidding and counter-price interconnector flows, a simplified congestion management mechanism should be implemented in the short term. This mechanism could be introduced via relatively straightforward changes to AEMO's settlement systems and could in effect be a stepping stone towards the full OFA model. A congestion management mechanism in itself would deliver significant gains. In particular, it could address much of the disorderly bidding problem, which would have flow on effects in terms of improving interconnector flows and the firmness of inter-regional hedges.

3.1 Incentives on TNSPs to meet the firm access standard

The AEMC proposes that a new firm access standard would require TNSPs to plan and operate the system to provide capacity to underpin firmer rights. The firm access standard would define the minimum network capacity that a TNSP would have to build and make available to underpin the financial rights issued to firm generators. The extent of TNSP's exposure will be determined by the definitions of the firm access scaling tiers and the incentive scheme developed by the AER.

The AER strongly supports enhanced incentives on transmission networks to maximise service capability. Proposals that increase TNSP exposure to the consequences of their operational and investment decisions whilst avoiding excessive risk are likely to be efficiency enhancing.

The second interim report proposes a specific incentive mechanism where a TNSP that fails to meet the firm access standard would be required to pay a penalty equal to some proportion of the costs to firm generators resulting from the breach.¹ This would be achieved through the application of a sharing factor.

There are a number of economic and practical issues that must be considered in order to develop an optimal incentive design. A number of the issues encountered by the AER when it developed the market impact component (**MIC**) of the transmission Service Target Performance Incentive Scheme (**STPIS**) are also relevant to the TNSP incentive scheme for the availability of firm access.

For instance, it may be difficult to predict the strength of the incentives generated by a mechanism which exposes TNSPs to a proportion of the gap between the regional and local price. While the AEMC has proposed that there would be a cap on the payout by TNSPs, the AER believes that this mechanism could become ad-hoc in nature. Given the high market cap, a TNSP could reach its cap in a very small number of trading intervals. Another key issue confronting the AER when it developed the MIC was the impact of disorderly bidding, which meant that minor congestion issues had a disproportionate impact on metrics for market congestion. As a result, the AER developed a pragmatic scheme based on the duration of material congestion arising during network outages, where material congestion is defined as a \$10/MWh marginal increase in the cost of dispatch. If a TNSP reduces the duration of material congestion compared to previous performance then it is rewarded, based on a percentage of its maximum annual revenue. The reward for improving (or penalty for reducing) performance is not related to the actual spot market impact, as it is extremely volatile and impossible to determine because the actual impact also depends on financial risk management products.

While reforms to address disorderly bidding will resolve some of the issues discussed above, the AER believes that it is important that there is an opportunity to consider all the relevant issues when finalising the design of the firm access standard incentive. Accordingly, the AER supports flexible arrangements which permit the AER to design an incentive which considers the economic and practical consequences of different approaches, having regard to the broader regulatory framework.

3.2 Access charges

The price firm generators pay for obtaining access rights would be determined using a Long Run Incremental Cost (**LRIC**) methodology which would be designed to reflect the incremental cost of providing access. The LRIC model attempts to identify the additional costs that arise when a generator access request causes a future, already planned expansion to be brought forward.

¹ AEMC, *Transmission Frameworks Review Second Interim Report*, pg 37.

The LRIC methodology is effectively a compromise between deep connection charges and long run marginal cost models. The AER supports further consideration of how the LRIC model could work in practice, with actual modelling of some examples in the NEM. Also, given recent outcomes in the NEM, the AEMC should consider how the LRIC methodology would work in the context of falling demand.

The AER has concerns about the prospect of consumers funding inefficient transmission investment. The LRIC model, as it is highly dependent on forecasts, could potentially be gamed by TNSPs with an incentive to build assets. Hypothetically, a TNSP could make the generator access charge inefficiently low by making unrealistic assumptions about future investment requirements. The AER would be restricted in its ability to challenge the need for an investment which is triggered by a generator access request. Accordingly, there is a risk that TNSPs could apply the LRIC in a way that allows them to build assets in excess of efficient requirements, by offering generators firm access rights at below efficient cost. These assets would enter the regulatory asset base and consumers would fund the difference between the actual cost of the asset and the cost borne by generators via access charges.²

The AEMC has suggested that if systematic errors in the charging methodology lead to under-pricing of access rights, it may be necessary to develop a mechanism to allow the TUOS revenue cap to be adjusted (similar to a contingent projects mechanism). This matter should be considered further following the detailed development of the firm access charging methodology. Other mechanisms to ensure that consumers do not fund unnecessary investments should also be considered.

The AER also notes that the AEMC has not yet formed a view on who should undertake firm access pricing. The AEMC Technical Report states that given the cross-regional issues, it would be arguable that a NEM-wide institution which had a NEM-wide transmission model and demand and generation forecasts would be preferable.³ Such a body would presumably have to be AEMO, given its roles with demand forecasts, generation forecasts and transmission planning. However, the AEMC recognises that there may be inefficiencies in separating pricing from access procurement.

The AER believes that AEMO should have the access pricing role and potentially also the access procurement role. AEMO will be able to take a nationally consistent approach and will be able to utilise its generation sector expertise. The AER also considers that there are benefits arising from AEMO's independence as a decision maker.

The AEMC has suggested that separating investment decisions from operational decisions could prevent the relevant parties from taking on an efficient level of risk. However, it is not in the nature of a monopolist to take on the efficient level of risk. A monopolist, if given the choice, is likely to push a much greater proportion of risk onto their counter-parties than would occur in a competitive market.

3.3 Transitional arrangements

The OFA model entails a significant learning process for industry participants. Transitional arrangements are necessary to ensure that the changes are introduced smoothly.

The AER gives qualified support to the proposed transitional arrangements. However, since the transitional arrangements will result in temporary grandfathering of arrangements which will favour incumbents over new entrants, we support a short transition period. We support further consideration of the potential barriers to entry for new entrants associated with the proposed transitional

² *Technical Report: Optional Firm Access*, Transmission Frameworks Review, AEMC Staff Paper, 15 August 2012, p59.

³ *Technical Report: Optional Firm Access*, Transmission Frameworks Review, AEMC Staff Paper, 15 August 2012, p45.

arrangements. We also have specific concerns relating to the delay to the implementation of a congestion management scheme (see section 3.4) and the manner in which the proposed transitional arrangements will apply to interconnectors (see section 3.5).

3.4 Dealing with disorderly bidding as matter of priority

The AER considers that disorderly bidding creates significant inefficiencies in the market. While the phrase ‘disorderly bidding’ does sound pejorative, the AER recognises that generators are simply responding to the market design and protecting their interests. Not only does disorderly bidding create inefficiencies in dispatch, it has very significant flow on effects in terms of inter-regional flows (in particular, it makes inter-regional hedging much more difficult), which adds risks for generators and reduces competition between generators in adjoining regions. The additional risks for generators create higher costs, which are ultimately borne by consumers.

While infrequent disorderly bidding may not give rise to serious harm, in practice it is a problem that has arisen again and again in nearly all regions of the NEM. Furthermore, although the problem arises only occasionally, it generally arises at peak periods, when the price signal is of critical importance in terms of investment signals.

Over the last 12 months, the problem has increased. The AER will separately provide a detailed report on recent examples of congestion in Queensland, New South Wales and Victoria, which provides a perspective on the seriousness of disorderly bidding (particularly the effect on interconnector flows). The AER also notes the work of AEMO in calculating some of the direct dispatch inefficiencies of disorderly bidding.

As noted earlier in this submission, given the seriousness of the disorderly bidding issue, the AER considers that a congestion management solution should be adopted in the short term, ahead of possible implementation of the full OFA model. A short-term congestion management solution could be based on the Shared Access Congestion Pricing model proposed by the AEMC in its first interim report.

3.5 Treatment of interconnectors

The AER supports the development of mechanisms to enhance trading between regions. The proposals aim to provide substantially firmer interconnector access which would help to address current problems associated with counter-price flows and promote inter-regional trade. They also aim to increase opportunities for investment in interconnectors by allowing potential beneficiaries to contribute to the cost.

However, the AEMC’s plan to allocate access rights according to historical average flows has the potential to work against the interests of interconnectors. Disorderly bidding and the absence of ramp rates on interconnectors act to ensure that interconnectors are first to have their access curtailed in the event of congestion. Accordingly initial allocation of firm access rights based on historical averages is likely to be low, with the result that consumers will need to fund further investment in order to achieve levels of capability that should have been provided as a consequence of the original investment.

The AEMC should consider whether there is scope for initial firm access rights for interconnectors to be allocated more fairly—potentially by having regard to the interconnectors’ quantity of inter-regional settlement residues made available for auction rather than the interconnector’s historical average flows for the purposes of allocating transitional firm access rights.

3.6 Integrating demand management solutions

The current design of the optional firm access model relies on network augmentation to meet generator access requirements. Demand management can act as a substitute for network augmentation at significantly lower cost.

The AER would like the AEMC to consider whether firm access rights could be made available to generators who enter into contracts with demand management service providers. For this approach to work, it would be necessary to identify nodes where the demand management must occur in order to alleviate congestion. A firm generator whose demand reduction failed to eventuate would be ineligible for compensation. This risk would need to be reflected in commercial contracts.

This concept has the potential to create a new market for demand management services which is not dependent on co-operation from monopoly network businesses. It has the potential to complement the AEMC's work in the Power of Choice Review. The AER understands that some generators already enter into contracts with demand management service providers in order to manage their volume risk. However, the interactions with the remainder of the optional firm access model would need to be considered further.

Regardless of whether this suggestion is adopted, it is important that demand side options are assessed as part of any model for identifying measures to meet a given access request. The LRIC methodology should ensure that demand management and other non-network options are included in the assessment of efficient future costs.

3.7 Interaction with revenue determination

Revenues from the provision of firm access to generators would be treated as a prescribed service. Accordingly, it would be necessary to reach a view on forecast revenue from firm access charges at the time of the regulatory determination in order to deduct forecast generator access revenue from the TNSPs' maximum allowed TUOS revenues. The AER agrees with the reasoning behind this proposal although we note that it will add a further dimension to the regulatory determination process.

Treating firm access charges as prescribed has a further advantage in that it could promote timeliness in the provision of connection services, since a TNSP that fails to complete a proposed connection on schedule may under-recover on their allowed firm access revenues.

4 Connections

The AEMC proposes to introduce a number of measures that are intended to strengthen the position of connection applicants when negotiating with TNSPs. These include:

- clarifying the relevant provisions of the Rules
- strengthening connection applicants' negotiating position by requiring TNSPs to provide more information
- establishing a regulatory framework for network extensions, which are currently treated by TNSPs as outside the Rules.

The chapter sets out the AER's views on the AEMC's proposals to strengthen connection applicants' negotiating position. It also comments on the AEMC's proposed framework for network extensions, in particular the arrangements which would allow non-TNSPs to own network extensions.

4.1 Strengthening connection applicants' negotiating position

The AEMC's proposals in relation to connections represent an improvement on the status quo.

However, while the connection applicant's negotiating position is stronger, they are still negotiating with a monopoly. It is unclear, for instance, what difference an obligation on the TNSP to "take account of the applicant's preferences in its choice of contractor" is likely to mean in practice. While the additional transparency will enhance the generators' grounds for seeking recourse via a dispute resolution mechanism, generators have already indicated that for various reasons they are unwilling to take this course of action.

The AER believes that further benefits would have been achievable if the AEMC had gone further in attempting to introduce competition to the connections framework. The AEMC rejected the AER's proposal for contestable connections on grounds that:

- the incumbent TNSP needs to be closely involved in design and construction in order to ensure that security and reliability of the network
- since liability lies with the TNSP, transferring that liability would involve significant transaction costs that would outweigh any benefit from increased contestability.

The AER is not persuaded that there are excessive risks to TNSPs associated with a contestable connections model. If the necessary changes to the institutional framework are implemented, there is no reason why design and construction of connection assets could not be undertaken on a competitive basis. This model works in other jurisdictions. Further, TNSPs already contract out design and construction work to the same contractors that are likely to be engaged by generators under a contestable connections model.

Issues associated with transferring liabilities could be addressed through a combination of regulated minimum standards (which connection applicants and AEMO would be required to uphold) and a cost pass through mechanism to protect TNSPs from risks associated with improperly designed or constructed assets.

4.2 Exemptions from obligation to register as a TNSP

The AER welcomes the aspects of the AEMC proposals which, for private network assets, clarify the rights of access, the dispute resolution provisions and the change of status of connection assets when serving third parties. In the AER's view, the National Electricity Rules (NER) are unclear when a privately owned connection asset is used to service a third-party. The AER believes the continued classification as a connection asset is not correct in these circumstances. However, this situation is not clearly addressed in the NER. As the AEMC report points out, differing views exist as to the regulatory status of transmission connection assets. The AER also supports the application of open access principles on sound commercial terms to significant privately owned connection assets. These lines frequently exist in remote areas where duplication would be economically prohibitive. Subject to the reasonable commercial interests of the first-mover being preserved, the AER considers access should be available on cost-reflective terms.

The AER has reservations about the proposed regulatory framework to apply to network extensions that are built by a party other than the local TNSP. We consider that the AEMC should consider versions of a build-own-transfer model.

In particular, the AER has concerns about arrangements which allow generators (or other non-TNSP businesses) to control assets that are the subject of a third party access request. To expose such parties to the full regulatory framework would be extremely onerous, but to permit an attenuated regulatory regime to apply to certain connection applicants is potentially inequitable.

The AEMC's proposals also carry the risk of additional "mini" TNSP resets which would need to follow the Chapter 6A revenue determination framework. The revenue determination process involves a major administrative burden, even if the network in question is small. In the AER's existing network registration exemption guideline we state:

The formal determination of network charges by the AER is a complex and involved process, the costs of which will usually be disproportionate to the scale of a private network.⁴

If the AER is to efficiently make revenue determinations for minor networks not owned by a registered network service provider, a streamlined process should be developed to facilitate this role, both for transmission network assets and for distribution network assets. We note that most connections of small to medium scale generation occur on distribution networks, which are outside the scope of this review. Yet the issues of access and pricing of the provision of network services are very similar if not identical in private distribution networks.

We note that the AEMC has proposed creating a registrable exemption for transmission assets up to two kilometres in length but proposes the AER make individual determinations for private assets greater than two kilometres in length. Under the current framework the AER has limited authority to apply a revenue determination process outside the scope of Chapter 6A. To determine a revenue entitlement will effectively require installations to register as a TNSP and the full requirements of Chapter 6A to apply. We think this is not a desirable approach and would frustrate the implementation of the reforms proposed by the AEMC.

Beyond permitting a private line to be exempt, little useful purpose will be served by an individual exemption. The matters most likely to be subject to an application for a variation of standing conditions are registration, dispute resolution, metering, third party access requirements and pricing. It is difficult to conceive of circumstances which would warrant a variation to any of the standing conditions.

⁴ AER, Electricity Network Service Provider Registration Exemption Guideline, 16 December 2011, p22..

If the intention is that the AER may determine a revenue entitlement for an exempt asset providing prescribed services then a new power is required. If the AEMC decides to maintain these proposals, the AER should be given power in appropriate circumstances to determine that these networks may be either non-regulated or subject to light handed regulation and a simplified pricing determination.

We also note that apart from generator connections, most existing privately owned exempt transmission networks over two kilometres in length are founded on serving mining developments in the less populous areas of Australia. All of these developments would be subject to substantial new obligations under the AEMC's proposals. We consider making explicit provision for open access to such networks to be consistent with established practice for such developments. Similarly, expanding on the scope of dispute resolution arrangements for private networks is supported, but care should be exercised to ensure that the arrangements specified can cater for the diverse range of likely access seekers. These may range from remote households through to major industrial loads or generators.

The AER supports a modified version of the build-own-transfer model whereby the ownership of the asset remains with the generator⁵ and the conditions in the generators' exemption from the obligation to register as a TNSP include:

- the generator must permit the local TNSP to operate the network extension as if it were part of the shared transmission network, subject to the principle set out below
- the TNSP may undertake works on the asset, including to connect third party access seekers
- third party connectees to the extension may not undermine the incumbent generator's access to the extension and must contribute their share of the cost of the extension.

The arrangements would establish the principle that beyond meeting minimum technical standards, a generator is entitled to choose the quality of extension assets required for the sole purpose of linking the generator to the shared transmission network.

If the generator-owned asset is required for a purpose beyond linking its owner to the shared network, and a TNSP incurs additional capital costs because the generator did not build the asset to the standard required of the shared network, then the TNSP would be eligible for a capex allowance in respect of expenditure they incur to upgrade the asset.

⁵ The AEMC and Grid Australia have suggested that the traditional build-own-transfer model is problematic from a taxation perspective, since TNSPs incur a tax liability in respect of gifted assets.