

4 April 2011

Mr Chris Pattas
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne Victoria 3001

Cc AERinquiry@aer.gov.au

Dear Mr Pattas

**UPGRADE OF ELECTRICITY SUPPLY OF PREMISES OWNED BY SIETEL LIMITED AT
463-467 WARRIGAL ROAD, MOORABBIN VICTORIA**

Endeavour Energy welcomes the opportunity to comment on the draft decision of the Australian Energy Regulator (AER) on the proposed standard lease, provided by United Energy Pty Limited (United Energy) on 31 July 2009 for an upgrade of electricity supply of the premises owned by Sietel Limited (Sietel) at 463-467 Warrigal Road, Moorabbin, Victoria.

Background

Sietel requested United Energy to upgrade electricity supply to its premises at 463-467 Warrigal Road, Moorabbin, Victoria (Land). The electricity upgrade requires the replacement of a 500kVA transformer with a 750 kVA transformer located at the Land and is for the sole use of Sietel or its tenant.

On 31 July 2009, United Energy provided a standard offer to Sietel to undertake the upgrade works for a cost of \$36,527 and under the condition that Sietel enters into a lease agreement with United Energy over the Land for a period of 30 years with a 30 year extension at the option of United Energy.

The lease for the substation building/room establishes the right of United Energy to house its equipment as well as its right to access the equipment.

Sietel considered the proposed 30 year lease with a 30 year option, exercisable only by United Energy was neither fair nor reasonable, and declined to sign the connection offer.

Sietel identified the following issues in support of its position:

1. there is no lease under existing arrangements between Sietel and United Energy covering the 500kVA transformer;
2. the existing 500kVA transformer was installed many years ago and the building serviced by the 500kVA transformer is approximately 50 years old;

3. the Land may be developed in the foreseeable future and a 30 year lease would significantly impact on the value of the land holding;
4. the transformer is located in a prominent position which, while acceptable for an industrial site, is not acceptable if the Land was used for a different purpose and as a consequence would significantly impact on the value of the Land; and
5. when the Land is developed, the new transformer will not be required.

On 22 October 2011, United Energy provided Sietel with a draft of a revised lease. The draft revised lease provided Sietel with the right to request the removal of the assets from the Land and in the event of the removal of the assets, United Energy would, on request, provide an executed deed of surrender.

Under this draft revised lease, the decision to remove the assets from the Land at the sole discretion of United Energy was retained.

The AER considered the 30 year lease was overly onerous and went beyond the legitimate interest of United Energy. It identified 2 options to make the terms and conditions of the lease fair and reasonable, being:

- United Energy offers a lease with a shorter duration which reflects the operational needs of Sietel; or
- United Energy provide a lease with a guaranteed right of termination by Sietel.

The AER's preliminary position is that a lease of 5 years (with a 5 year extension option available at Sietel's request should it still have the need for the transformer) would be fair and reasonable.

Alternatively, the AER considers that United Energy could provide Sietel with a lease that grants Sietel a unilateral right to terminate the lease.

Issues

Connection life v. Life of Asset

Endeavour Energy notes that Sietel has suggested that the property will be developed in the foreseeable future and that the transformer will not be required from that point in time. However, Sietel does not provide any certainty that it will sell or develop the Land in 5 years. On this basis it would be inappropriate and unreasonable to require United Energy to have a 5 year lease for a connection asset that may have a life of 50 years unless the life of the connection contract is also for 5 years.

This inconsistency gains greater emphasis when it is borne in mind that the lease is a for peppercorn amount and the costs of renegotiating the lease after every 5 years, or 10 years if the 5 year extension is exercised, are not insignificant.

Administrative and other costs

Given the administrative costs in renegotiating a lease, the peppercorn amount currently paid for the lease by United Energy and the cost recovery mechanism employed by United Energy to recover the costs of the transformer, the application of Guideline 14, which allows a distributor to charge new connecting customers for the costs attributable to their connection life, assumes greater importance. In the Citipower example cited by the AER, the Guideline 14 assumed period was 15 or 30 years. As the life of Sietel's connection contract is greater than 5 years, it would also appear that the application of a 5 year lease would appear inconsistent with Guideline 14.

Should Sietel not sell or develop the Land in 5 years the lease would need to be renegotiated. To have to renegotiate short term connection agreements for short duration projects (such as in Sietel's case every 5 years) is an inefficient allocation of resources and would appear contrary to the long term interests of consumers of electricity with respect to the reliability, safety and security of the National Electricity system.

Planning considerations

The AER has stated that the network planning and benefits to the broader community are not as relevant as the asset is not used by other customers. However, the recognition by the AER that the asset may only be used for 5 years before redevelopment of the Land also means that any benefits accruing from the asset after 5 years are not taken into account.

Additionally, the AER's draft view on the revised lease of 22 October 2010, that the removal of the asset at the discretion of United Energy is insufficient to offset its concerns with the length of the lease, does not address the possibility of the transformer being applied to more customers than Sietel.

It is neither fair nor reasonable to dismiss the contention of United Energy that other customers may later benefit from the transformer, particularly in the case where a 5 year lease applies. In the case of Sietel remaining and new customers utilising the asset and in the case of the asset being removed and reutilised by future customers, the costs and lease period relating to the asset need to be addressed.

Where customers other than Sietel utilise the asset, the need for a longer lease period which addresses the customer connection life must be recognised.

Signalling costs of investment

Failure to recover commercial costs from Sietel and the additional costs of installation and removal, of the assets to accommodate other customers in future, all increase the costs for those future customers using the asset.

Given that the asset is solely dedicated to Sietel, an alternative treatment for the transformer work upgrade cost (calculated on both installation costs and usage charge) is that it be borne by Sietel only. Sietel could then remove the transformer as its operational needs dictate.

Endeavour Energy notes the comment by the AER that it *"does not expect this draft decision to set a precedent for a significant number of United Energy's customers"*¹ (thereby confirming a precedent has been set) and that *"this decision is not a decision on the fairness or reasonableness of United Energy's standing offer"*².

The lease provisions are terms and conditions in the standing offer, as acknowledged by the AER in its statements:

*"the AER accepts United Energy's preference to offer standard lease terms to all connecting customers. However, the AER considers that inflexibly applying a standard period lease to all connections regardless of size, cost, location of the assets and circumstances of the land may, in some cases, result in the terms and conditions not being fair and reasonable"*³; and

*"United Energy may consider offering contracts which differ from its standard contract."*⁴

As such the decision of the AER is on the fairness and reasonableness of the terms and conditions in the standing offer, and not on the site.

To suggest otherwise is to require different lease terms and conditions in standing offers for every different site, which Endeavour Energy considers unreasonable.

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

Yours sincerely



Rod Howard
Group General Manager Network

¹ AER, *Draft Decision, Upgrade of electricity supply of premises owned by Sietel Limited (ACN 004 217 734) at 463-467 Warrigal Road, Moorabin Victoria*, p16

² p16

³ p15

⁴ p15