

Suite 201 T: + 61 3 9929 4100
18 Kavanagh Street F: + 61 3 9929 4101
Southbank Vic 3006 E: info@cleanenergycouncil.org.au
Australia W: www.cleanenergycouncil.org.au
ABN: 84 127 102 443



Monday, 27 August 2012

Warwick Anderson
General Manager, Network Regulation
Australian Energy Regulator
PO Box 3131
Canberra, ACT, 2601
By Email: AERinquiry@aer.gov.au

Dear Warwick,

RE: Clean Energy Council Submission to the Australian Energy Regulator on the 2013-18 ElectraNet Determination

The Clean Energy Council (CEC) welcomes the opportunity to participate in the consultation for ElectraNet's 2013-18 determination. In particular the CEC considers that the opportunity to engage with the AER on matters relating to the proposed negotiated transmission service criteria (NTSC) and ElectraNet's proposed negotiating framework is timely in light of other ongoing rule changes and market reviews.

The CEC is the peak body representing Australia's clean energy and energy efficiency industries. Its priorities are to:

- create the optimal conditions in Australia to stimulate investment in the development and deployment of world's best clean energy technologies
- develop effective legislation and regulation to improve energy efficiency
- work to reduce costs and remove all other barriers to accessing clean energy

The CEC works with over 550 member organisations and governments to identify and address the barriers to efficient industry development in the energy efficiency and stationary energy sector. The clean energy industry contributes to the generation of electricity using wind, hydro, solar, biomass, geothermal and marine energy as well as the emerging technologies and service providers in the energy efficiency sector including solar hot water and cogeneration.

In particular the CEC notes that the current arrangements for negotiations for negotiated services have provided inadequate outcomes to date. The CEC observes that these outcomes are subject to both the National Electricity Rules (NER) and the transmission network service provider's (TNSP) negotiation frameworks. As a result the Australian Energy Regulator (AER) must not consider other activities in the market as externalities and play a role in rectifying observed deficiencies wherever possible.

Introduction

In general the CEC is pleased with the structure of ElectraNet's negotiating framework as presented and accepts that it closely aligns with the minimum requirements of NER Clause 6A.9.5. In conjunction the AER's NTSC is sufficiently aligned with the requirements of NER Clause 6A.9.1. However, the CEC would like to provide the following discussion and proposed changes in light of the outcomes of other market reviews and processes currently under way.

The CEC's views are founded on the evident failings of the 'negotiate / arbitrate' model as applied by the NER and the lack of prescription to support the principle of good faith, as discussed below.

Negotiation frameworks

The CEC believes that the NER envisages negotiations between two equally resourced and powerful entities: the Service Applicant and the transmission network service provider. The rules intend that the National Electricity Objective (NEO) is best met by this condition as an economically optimum outcome should result from it. Commercial arbitration supports the process by presenting the risk of a non-favourable outcome for either party.

Despite this the Australian Energy Market Commission's (AEMC) ongoing Transmission Frameworks Review is revealing that this simplistic assertion is presenting some significant failings. Numerous submissions to the review from generators, and some of Australia's largest and most experienced companies are revealing that their individual experiences are far from this ideal. These positions have been strongly stated in submissions to the review. Some are summarised below.

Prior to presenting an alternative arrangement for connections AGL's submission to the Directions Paper stated

*"AGL seeks a range of evolutionary improvements that recognise the unbalanced negotiating positions of the parties from the current arrangements. To this end the proposals are intended to require TNSPs to adopt more of an open book approach to negotiating prices."*¹

TRUenergy's submission to the First Interim Report called for stronger economic regulation of negotiated services on the basis that

*"they have always felt that there has been an imbalance in the bargaining power when negotiating with a monopoly service provider during the connection process".*²

¹ AGL, 2011, *Transmission Frameworks Review – Directions Paper*, p. 17, available: www.aemc.gov.au.

² TRUenergy, 2012, *Transmission Frameworks Review – First Interim Report*, p. 7, available: www.aemc.gov.au.

Infigen Energy's submission to the First Interim Report observed that

“substantial improvements are needed with regards to the connection of new generation plant” and then almost entirely focussed on connection issues. It went on to state that *“the Countervailing Market Power, of even the largest generators, is Near Zero; The Substitution Possibilities are normally Non-Existent as the NSP's network is normally the only one present; The Information Asymmetry is typically around 20:1 due to the lack of commercial (and technical) transparency.”*³

Further empirical evidence of flaws in the current negotiate / arbitrate model were also presented in submissions by the CEC and the Private Generators which collectively represent the vast majority of actively developing generator proponents, renewable or otherwise.

Good faith provisions

The CEC's view is that the provisions of good faith alone are insufficient to have a material impact on the negotiation process. While necessarily defined in a legal context, this simple statement has no material significance when it is insufficiently supported. When other clauses and obligations relating to the provision of information, technical standards or process timing are not sufficiently prescriptive 'good faith' will only apply to the extent of the scope of these rules. Thus they will remain open to interpretation.

Although commercial negotiations do rely on this provision, it is the scope of the NER which provide support to the negotiations in outlining each party's obligations. In the AEMC's current Rule change process for the Connection of Embedded Generation the proponent made clear that the provision of good faith was insufficient in relation to the negotiations for small embedded generator connections. The CEC argued that it was not the provision of good faith that was failing. Rather it is a clear lack of prescription in the NER in relation to the connection process for small embedded generators that leads connection applicants to believe that good faith has not been applied.

Summary

In summary it is evident that each party involved in negotiations must be equally supported by the relevant regulatory framework in order to ensure that the 'negotiate / arbitrate' model can be applied as intended by the NEO. The provision of good faith can only be seen to support the process.

In light of this the CEC's view is that the NTSC should be refined for clarity and, as a form of indirect regulation, the negotiation framework needs to be refined both for clarity and to be clearly equal in prescribing obligations on each party. The following points outline the CEC's proposed changes to both and reasoning.

³ Infigen Energy, 2012, *AEMC Transmission Frameworks Review, Project Number: EPR0019*, p. 6, available: www.aemc.gov.au.

AER Proposed Negotiated Transmission Service Criteria

Unreasonably onerous risk

Paragraph 3 states

“The terms and conditions of access for negotiated transmission services, particularly any exclusions and limitations of liability and indemnities, must not be unreasonably onerous. Relevant considerations include the allocation of risk between the TNSP and the other party, the price for the negotiated transmission service and the cost to the TNSP of providing the negotiated service.”

The paragraph implies that there is a ‘reasonableness test’. However, the AER has not provided any detail on what would be ‘unreasonably onerous’.

As an example TNSPs have a general requirement for a Service Applicant to provide bank guarantees, to the value of the negotiated transmission service to a TNSP to undertake the service. As a result the TNSP is carrying little risk in undertaking the service. In general commercial contract principals should dictate low profit margins to the TNSP as a result. However, the lack of transparency on the TNSP’s costs and pass-through arrangements provide no certainty of this and experience indicates that a commercial return is made by the TNSP. Therefore, the Service Applicant could easily be exposed to terms which would be considered unreasonably onerous under any other commercial contract arrangement.

As the effective ‘administrator’ of the negotiation frameworks the AER has a responsibility to consider the reasonableness of terms and conditions of access, to define the limits of reasonableness and apply a test in order to support this criterion.

Costs

Paragraph 5 states

“The price of a negotiated transmission service must reflect the cost that the TNSP has incurred or incurs in providing that service, and must be determined in accordance with the principles and policies set out in the Cost Allocation Methodology.”

As discussed above there is no requirement for transparency to support the criterion that the price reflects costs. Therefore, as a stand-alone requirement this has little bearing.

In conjunction to the above the provision of negotiated services is funded by the Service Applicant, rather than consumers. While Paragraph 1 outlines that the NEO should prevail this does not explicitly recognise efficient costs for the provision of negotiated services. The CEC’s view is that this paragraph should be reconsidered as

“The price of a negotiated transmission service must be shown to efficiently reflect the cost that the TNSP has incurred or incurs in providing that service, and must be determined in accordance with the principles and policies set out in the Cost Allocation Methodology.”

As discussed below this rewording would also align the NTSC with the intent of NER Clause 6A.9.5(c)(3).

ElectraNet’s Proposed Negotiating Framework (Appendix G)

Acknowledgement of negotiation framework

Paragraph 3.3 links the timeframe for negotiations to the connection program determined between the parties as prescribed by NER Chapter 5. However, the negotiation framework is an externality to the Chapter 5 connection process and there is no obligation for a TNSP to disclose the framework to the Service Applicant.

The CEC suggests that the following paragraph 3.3.3 be inserted:

“As a component of the obligations of Clause 5.3.3(c)(6) of the NER ElectraNet will provide the Service Applicant with the negotiation framework (this document) in response to the Connection Enquiry.”

Changes to the timeframes subsequent to material changes to the application

Paragraph 3.6.2 states that the timeframe for negotiations determined under NER Chapter 5 will

“recommence if there is a material change in the Negotiated Transmission Network service sought by the Service Applicant, unless ElectraNet agrees otherwise.”

Given that the timeframe determined in Chapter 5 relates to the connection process from the initial stages through to making a connection offer the relationship is not clear. In conjunction, although the Service Applicant would have made a significant financial commitment to process the application this paragraph appears to imply that ElectraNet can stop the process and request to be paid again in full irrespective of the scope of a proposed change to the service sought.

In order to avoid the risk of terms of access becoming unreasonable onerous and to align this paragraph with the intent of the principle of good faith, the CEC recommends that this paragraph be re-phrased to state

“can be adjusted subject to any material change in the Negotiated Transmission Network service sought by the Service Applicant, under the condition that the adjustment is relevant to the scope of the material change and both parties agree.”

Costs for Negotiated Transmission Services

Paragraph 6.1.3 states that ElectraNet will provide

“the reasonable costs and/or the increase or decrease in costs (as appropriate) of providing the Negotiated Transmission Service to the Service Applicant which demonstrate to the Service Applicant that the charges for providing the Negotiated Transmission Service reflect those costs and/or the cost increment or decrement (as appropriate).”

to the Service Applicant, which in the CEC’s view is inconsistent with NER Clause 6A.9.5(c)(3). This clause out the minimum requirement for the negotiation framework as

“a requirement for the provider:

(i) to identify and inform a Service Applicant of the reasonable costs and/or the increase or decrease in costs (as appropriate) of providing the negotiated transmission service; and

(ii) to demonstrate to a Service Applicant that the charges for providing the negotiated transmission service reflect those costs and/or the cost increment or decrement (as appropriate)”.

The implications of this interpretation are significant. The negotiation framework appears to indicate that the price provided to the Service Applicant will inherently indicate the costs to ElectraNet of providing the service. However, the NER stipulates that the TNSP must disclose its costs to provide the service and then demonstrate that the charges to the Service Applicant are reflective of those costs, as two separate stages.

The CEC acknowledges that the NER remains open to interpretation. However, its interpretation should be considered in the context of the minimum requirements for negotiation, implying the intent for a level of information transparency in order to support negotiations.

ElectraNet’s interpretation is that a single figure will suffice as this will demonstrate the costs and subsequently, the charge. However, in the context of a negotiation framework the CEC’s interpretation of paragraph (i) is that that the costs are required to be provided in order that the Service Applicant can negotiate effectively.

Not only is this interpretation consistent with the intent of the principle of good faith and equal negotiating positions as intended by the NEO, it is also consistent with the AEMC’s findings in recent Second Interim Report for the Transmission Frameworks Review⁴.

The ElectraNet Cost Allocation Methodology provides some insight into the scope of cost breakdowns which should be applied, including:

⁴ AEMC 2012, Transmission Frameworks Review, Second Interim Report, p-p. 83-92, 15 August 2012, Sydney.

- Directly attributed costs including those related to
 - Each division including Finance & Corporate Development, Assets & Operations and Development & Projects
 - Corporate Overheads
- Casually allocated costs including those based on
 - Directly attributable timesheets & invoices
 - Shared costs based on casual allocations
- Capital expenditure, including a breakdown of the costs attributable to the asset construction, associated assumptions and calculation information along with supporting evidence.

The CEC's view is that there should be a standard level of information transparency on connection costs as this was the intent of the NER in supporting effective negotiations as intended in light of the NEO. The AER needs to recognise and acknowledge this intent by adjusting the negotiation frameworks appropriately to realign the framework with the NER by prescribing a standard level of costing information transparency.

Suspension of timeframes

Paragraph 9.1.1 suggests that the negotiation timeframe will become suspended if the Service Applicant does not acknowledge the receipt of commercial information within 15 days.

While this is an important aspect to ensuring the agreed timeframe is adhered to it is also equally as important to recognise that there are two information flow paths. This condition supports the TNSP but expects the Service Applicant to rely on good faith, which is inconsistent with the intent of the negotiate / arbitrate model (as discussed previously).

For the reasons above the CEC suggests that Paragraph 9.1.1 should read

“subject to the parties agreeing to a date for the undertaking and conclusion of commercial negotiations,

- (a) within 15 Business Days of the Service Applicant providing the Commercial Information to ElectraNet pursuant to paragraphs 4.1 or 5.1, ElectraNet does not formally accept that Commercial Information, or;*
- (b) within 15 Business Days of ElectraNet providing the Commercial Information to the Service Applicant pursuant to paragraphs 6.1 or 7.1, the Service Applicant does not formally accept that Commercial Information.”*

Transparency of TNSP activities

With regards to the payment of ElectraNet's costs Paragraph 11.3 states that

"From time to time, ElectraNet may give the Relevant Service Applicant a notice setting out the reasonable Costs incurred by ElectraNet and the off-set of any amount applicable under paragraph 11.1."

Negotiations and subsequent contracting for the provision of negotiated services are subject to commercial contracts and should therefore be consistent with the general terms and conditions of such contracts. The application fee paid by the Service Applicant subsequent to NER Clause 5.3.3(c)(5) can be significant and in the range of around \$100-300k. It is highly unlikely that normal contract terms would permit reporting of the costs incurred and balance remaining on a 'time to time' basis, or without accountability for actions. Therefore, nor should such an arrangement with a TNSP to process a connection application.

The CEC notes that during this phase of the negotiations the Service Applicant is undertaking all risk by making advance payments to the TNSP. The TNSP needs to perform this work transparently and be accountable for cost and expenses. Without this transparency there is no guarantee that the costs can even be attributed to processing the application efficiently as expected by the Service Applicant and under the NEO. Further, there is a real risk that this lack of transparency could easily and very quickly lead to the unreasonable onerous risk that the AER is trying to avoid.

As discussed previously the provision of good faith is only reasonable to the extent that it is supported by other clauses in the NER. On this basis the CEC expects that the AER will accept the following changes to Paragraph 11.3

"On a monthly basis, ElectraNet will give the Relevant Service Applicant a notice setting out the reasonable Costs incurred by ElectraNet, in a format showing hours spent and subsequent costs, activities progressed and completed and the off-set of any amount applicable under paragraph 11.1."

Recognition of the negotiation framework in payment contracts

Paragraph 11.5 states that

"ElectraNet may require the Service Applicant to enter into a binding agreement addressing conditions, guarantees and other matters in relation to the payment of on-going Costs."

While this is acceptable, any binding agreement formed under this negotiation framework must recognise the terms and conditions of the framework itself. The CEC suggests the following changes

"ElectraNet may require the Service Applicant to enter into a binding agreement addressing conditions, guarantees and other matters in relation to the payment of on-going Costs, in accordance with the terms of this framework."

Treatment of residual value held by the TNSP

Although Section 12 considers the conditions under which a negotiation can be terminated it fails to capture the treatment of any residual value paid by the Service Applicant to the TNSP as part of the advance payment under NER Clause 5.3.3(c)(5). As the advance payment function mitigates the TNSP of any financial risk any residual value remaining must be refunded to the Service Applicant upon termination of the negotiations. This should be provided with a final breakdown of the costs incurred and time spent up to the close-out of the negotiations.

The CEC recommends that the following paragraph 12.3 be inserted into Section 12

“Upon termination ElectraNet must immediately cease any work, prepare a final summary of costs and expenses up to the time of termination and return any credit remaining from any application fee paid by the Service Applicant subsequent to Paragraph 11.1.”

Closing

In closing the CEC would like to reiterate the view that the current arrangements for the negotiation process have become problematic. As a result it is currently the subject of detailed review by the AEMC. This review has revealed that the NER’s assertion that “Service Applicants are well resourced, large and sophisticated therefore the NEO can be best facilitated through the negotiation process”, is incorrect. Some of Australia’s largest companies have publicly stated their disagreement through experience.

In many instances it is both the frameworks presented under the NER and the negotiation framework which have led to this outcome. As a result the AER must consider the issues and play a role in rectifying current deficiencies through the appropriate consideration of the negotiated transmission service criteria and the negotiation frameworks for TNSPs.

Please do not hesitate to contact the undersigned for any queries regarding this submission.

Yours sincerely,



Tom Butler | Network Specialist | Clean Energy Council

Direct +61 3 9929 4142

Mobile +61 431 248 097

Email tom@cleanenergycouncil.org.au