SITHE AUSTRALIA POWER SERVICES PTY LTD
v INTEGRAL ENERGY AUSTRALIA

DECISION

1. A dispute between Sithe Australia Power Services Pty Ltd ("Sithe") and Integral Energy Australia ("Integral") has been referred to this Dispute Resolution Panel under cl.8.2.6A of the National Electricity Code. Sithe is an Embedded Generator and Integral is a distribution network service provider ("DNSP") as defined in Chapter 10 of the Code. As registered Code Participants, Sithe and Integral are each bound by the Code, which has effect in NSW pursuant to the National Electricity (NSW) Act 1997.

2. Sithe operates a co-generation plant for the generation of steam and electricity at Smithfield on behalf of the companies that constitute the Smithfield Power Partnership. The Smithfield Plant, which is not connected to a transmission network but is directly connected to Integral's distribution network, is an Embedded generating unit. Integral is both a DNSP and a retailer of electricity. As a retailer, Integral acquires electricity from embedded generators such as Sithe and from NEMMCO. Integral purchases all electricity generated at the Smithfield Plant under a Power Purchase Agreement ("PPA") dated 17 February 1995. The PPA came into effect on 26 June 1995 with an operative term of 30 years from 27 June 1997. Although the PPA is a connection agreement as defined in Chapter 10, the Code did not come commence until 13 December 1998.

3. The total revenue that a transmission network service provider ("TNSP") or DNSP may derive from operating its network is determined in accordance with Chapter 6 of the Code. In NSW, each DNSP's annual aggregate revenue requirement (**"AARR"**) for providing prescribed distribution services is determined by the Independent Price and Regulatory Tribunal of New South Wales. A DNSP's AARR takes account of its payments to TNSPs and Embedded Generators.

4. Transmission use of system ("TUOS") charges that are payable by DNSPs to TNSPs consist of two components: a fixed charge which each DNSP pays for common network services (the "Customer TUOS General Charge") and a variable charge which is determined by reference to each DNSP's actual use of a TNSP's transmission network (the "Customer TUOS usage charge"). A DNSP does not pay a TNSP customer TUOS usage charges ("Avoided TUOS") in respect of electricity that the DNSP acquires from an Embedded Generator.

5. When the Code commenced on 13 December 1998, clause 5.5(f)(3) required a DNSP and a generator to "negotiate in good faith to reach agreement as appropriate" on a number of matters, including the:

> "(3) amount to be passed through to the Generator (where that Generator is an Embedded Generator) for avoided transmission use of system charges that would otherwise have been payable by the Network Service Provider as a result of the Generator not having been connected to its distribution network."

6. At that time, cl.5.5(h) provided:

"5.5(h) Any payments to Embedded Generators under clause 5.5(f)(3) are to be included as part of the aggregate annual revenue requirement of the Network Service Provider and are to be recovered in the same manner as payments to Embedded Generators under clause 6.13.3(d)."

7. On 6 December 2001, cll. 5.5(f)(3) and 5.5(h) of the Code were deleted and replaced by the following clauses 5.5(h), (i) and (j):

"(h) A *Distribution Network Service Provider* must pass through to an *Embedded Generator* the amount calculated in accordance with clause 5.5(i) for *Customer TUOS usage charges* that would have been payable by the *Distribution Network Service Provider* to a *Transmission Network Service Provider* had the *Embedded Generator* not been *connected* to its *distribution network* ("*avoided Customer TUOS usage charges"*).

(i) To calculate the amount to be passed through to an *Embedded Generator* in accordance with clause 5.5(h), a *Distribution Network Service Provider* must if *Customer TUOS usage prices* were in force at the relevant *transmission connection point* in the relevant *financial year*:

(1)

determine the *Customer TUOS usage charges* that would have been payable by the *Distribution Network Service Provider* for the relevant *financial year* if the *Embedded Generator* had not injected any *energy* at its *connection point* during that *financial year*; and

(2)

determine the amount by which the charges calculated in paragraph (1) exceed the *Customer TUOS usage charges* actually payable by the *Distribution Network Service Provider*, which amount will be the relevant amount for the purposes of clause 5.5(h).

Where *Customer TUOS usage prices* were not in force at the relevant *transmission connection point* throughout the relevant *financial year*, the *Distribution Network Service Provider* must apply an equivalent procedure to that described above in relation to that component of its *transmission use of system service* charges which is deemed by the relevant *Transmission Network Service Provider* to represent the marginal cost of *transmission*, less an allowance for locational signals present in the *spot market* to determine the amount for the purposes of clause 5.5(h).

(j) Any payments to *Generators* and *Embedded Generators* under clause 5.5(h) are to be included as part of the *aggregate annual revenue requirements* of the relevant *Transmission Network Service Provider* or *Distribution Network Service Provider* and are to be recovered in the same manner as payments to *Embedded Generators* under clause 6.13.3(d) (except that, where the *Generator* is connected to a *transmission network*, all references in clause 6.13.3(d) and schedule 6.3 to "*distribution*" are to be read as references to "*transmission*")."

8. For present purposes, it is not in dispute that Integral's AARRs for the period from 1 February 2000 to 30 June 2004 include Avoided TUOS that Integral claims that it has passed through in payments that it has made, or is liable to make, to Sithe under the PPA.

9. Sithe denies that Avoided TUOS is passed through in Integral's payments under the PPA and claims that Integral is obliged to "pass through" Avoided TUOS to Sithe by cl. 5.5(h). Integral has rejected Sithe's claim. The parties have executed a Dispute Resolution Agreement that includes a schedule containing a number of

questions for the Panel's determination but agree that only question 1 is required to be answered at this point. Questions 1 is as follows:

> "1. Do clauses 5.5(h) and (i) of the Code in themselves give Sithe a right to payment of Avoided TUOS by Integral?"

10. Briefly stated, Sithe's case is that cl.5.5(h) directly imposes a new, "stand alone" obligation on a DNSP to "pass through" Avoided TUOS to an Embedded Generator independently of any agreement between them, subject only to the possible operation of cll.5.2.2(b) and (c) of the Code. Sithe submitted that, subject to that qualification, question 1 should be answered in the affirmative. Integral argued that cl.5.5(h) does not impose a direct obligation on a DNSP to "pass through" Avoided TUOS to an Embedded Generator but only applies to a DNSP and an Embedded Generator that enter (or perhaps modify) a connection agreement after cl.5.5(h) came into effect and merely requires them to include an obligation for the DNSP to "pass through" Avoided TUOS to the Embedded Generator in such a connection agreement. The parties agreed that, if question 1 is answered in the negative, it is unnecessary for other questions to be considered because Sithe's claim must fail.

11. It is common ground that any obligation to "pass through" Avoided TUOS imposed by cl.5.5(h) operates only prospectively from the amendment of the Code on 6 December 2001 and that cl.5.5(h) must be construed taking account of its purpose and context, including objectives stated in the Code. Each party relied on the history of the amended provisions and the purposes of the amendment that are discernible in reports of the National Electricity Code Administrator ("NECA") and the Australian Competition and Consumer Commission ("ACCC") that preceded the amendment. Although the objectives provide broad guides that might be useful in some circumstances, eg, ambiguity, they do not provide significant assistance in relation to question 1. The reports, like the terms of cl.5.5(h), demonstrate a general intention to require DNSPs to "pass through" Avoided TUOS to Embedded Generators, but do not provide any reliable indication whether that obligation is intended to be universal or, if it is not universal, concerning the circumstances in which it is to apply or any qualifications to which it is subject. Question 1 must be decided by reference to the structure and language of the Code, especially Chapter 5.

12. Clause 5.1.1 identifies the persons to whom Chapter 5 applies, which include NSPs and Generators. Clauses 5.1.2 and 5.1.3 set out the "Purposes and aims" of Chapter 5 and the "Principles" on which it is based. They provide:

"**5.1.2 Purpose and aims**

(a) This Chapter of the *Code:*

(1)

provides the framework for *connection* to a *transmission network* or a *distribution network* and access to the *networks* forming the *national grid*; and

(2)

has the following aims:

(i)

to detail the principles and guidelines governing *connection* and access to a *network*;

(ii)

to establish the process to be followed by a *Code Participant* to establish or modify a *connection* to a *network*;

…..

….

5.1.3 Principles

Chapter 5 of the *Code* is based on the following principles relating to *connection* to the *national grid*:

(a) All *Code Participants* should have the opportunity to form a *connection* to a *network* and have access to the *network services* provided by the *networks* forming the *national grid*.

(b) The terms and conditions on which *connection* to a *network* and provision of *network service* is to be granted are to be set out in a commercial agreement on reasonable terms entered into between a *Network Service Provider* and other *Code Participants*.

….”

13. Clause 5.2 deals with “Obligations”, including a general obligations on Code Participants to “maintain and operate all equipment that is part of their facilities in accordance with the requirements of [the] Code” (cl.5.2.1). Clause 5.2.2 “Connection agreements” includes cll. 5.2.2(a) to (c), which provide:

> “(a) If requested to do so by a Network User, NEMMCO or NECA, a Network Service Provider and a Network User must document the terms of any network connection arrangements made prior to the Code commencement date and the resulting document will then be deemed to be a connection agreement for the purpose of this Code.
>
> (b) This Code applies to:
> (1) all connection agreements made after the Code commencement date;
> (2) all deemed connection agreements created pursuant to clause 5.2.2(a); and
> (3) all requests to establish connection or modify an existing connection after the Code commencement date.

(c) This Chapter 5 is neither intended to, nor is it to be read or constructed as having the effect of:

(1) altering any terms of a connection agreement;

(2) altering the contractual rights or obligations of any of the parties under the connection agreement as between those parties; or

(3) relieving the parties under any such connection agreement of their contractual obligations under such an agreement."

14. Clauses 5.2.3 and 5.2.5 set out the respective obligations of NSPs and Generators. Clause 5.2.3(d)(1) provides that a NSP must "review and process applications to connect or modify a connection which are submitted to it and must enter into a connection agreement with each Code Participant and any other person to which it has provided a connection in accordance with clause 5.3 to the extent that the connection point relates to its part of the national grid". Clause 5.2.5 (b) requires a Generator to "submit an application to connect in respect of new or altered equipment owned, operated or controlled by it and enter into a connection agreement with a Network Service Provider in accordance with clause 5.3 prior to that equipment being connected to the network of that Network Service Provider or altered (as the case may be)".

15. Clause 5.3 is headed "Establishing or Modifying Connection", with sub-headings 5.3.1 "Process and procedures", 5.3.2 "Connection enquiry", 5.3.3 "Response to connection enquiry", 5.3.4 "Application for connection", 5.3.5 "Preparation of offer to connect", 6.3.6 "Offer to connect", 5.3.7 "Finalisation of connection arrangements" and 5.3.8 "Provision and use of information".

16. Clause 5.5 deals with "Access arrangements for Generators" and cl.5.5A deals with "Access arrangements for Market Network Service Providers".

17. Clauses 5.5 (a) and (b) provide:

(a) The *Network Service Provider* referred to under this clause 5.5 is the *Network Service Provider* required under this *Code* to process a connection enquiry or to submit an offer to *connect* for the provision of *network service* to the *Generator's generating unit* or group of *generating units.*

(b) If requested by a *Generator*, whether as part of a *connection* enquiry, *application to connect* or the subsequent negotiation of a *connection agreement*, the *Network Service Provider* must negotiate in good faith with the *Generator* to reach agreement in respect of the *generator access* arrangements sought by the *Generator*.

18. Clauses 5.5A (a) to (c) provide:

(a) This clause 5.5A applies to circumstances in which a *Market Network Service Provider* has made a *connection* enquiry under clause 5.3.2 or has lodged an *application to connect* under clause 5.3.4 in relation to *network elements* used in the provision of a *market network service.*

(b) The other *Network Service Provider* referred to under this clause 5.5A is a *Network Service Provider* required under clause 5.3.3 to process and respond to the *connection* enquiry referred to in clause 5.5A(a) or required under clause 5.3.5 to prepare an offer to connect in response to the *application to connect* referred to in clause 5.5.A(a).

(c) If requested by the *Market Network Service Provider,* whether as part of the *connection* enquiry, *application* to *connect* or the subsequent negotiation of a *connection agreement*, the *Network Service Provider* must negotiate in good faith with the *Market Network Service Provider* to reach agreement in respect of the *market network service provider access* arrangements sought by the *Market Network Service Provider*.

19. It is unnecessary to set out any other part of cl.5.5A. Clauses 5.5(c), (e), (f) and (g) provide:

"(c) As a basis for negotiations under clause 5.5(b):

(1)

the *Generator* must provide to the *Network Service Provider* such information as is reasonably requested relating to the expected operation of its *generating units*; and

(2)

the *Network Service Provider* must provide to the *Generator* such information as is reasonably requested to allow the *Generator* to fully assess the commercial significance of the access arrangements sought by the *Generator* and offered by the *Network Service Provider.*

….

(e) The *Network Service Provider* shall use reasonable endeavours to provide the *generator access* arrangements being sought by the *Generator* subject to those arrangements being consistent with *good electricity industry practice* …

(f) The *Network Service Provider* and the *Generator* shall negotiate in good faith to reach agreement as appropriate on the:

(1)

connection service charge to be paid by the *Generator* in relation to *connection assets* to be provided by the *Network Service Provider*;

(2)

use of system services charge to be paid by the *Generator* in relation to any *augmentations* or *extensions* required to be undertaken in respect of all affected *transmission networks* and *distribution networks (“negotiated use of system charges”)*;

(3)

[Deleted]

(4)

amount to be paid by the *Generator* to the *Network Service Provider* in relation to the costs reasonably incurred by the *Network Service Provider* in providing *generator access*;

(5)

compensation to be provided by the *Network Service Provider* to the *Generator* in the event that the *generating units* or group of *generating units* of the *Generator* are *constrained off* or *constrained on* during a *trading interval*; and

(6)

compensation to be provided by the *Generator* to the *Network Service Provider* in the event that *dispatch* of the *Generator's generating units* or group of *generating units* causes another *Generator's generating units* or group of *generating units* to be *constrained off* or *constrained on* during a *trading interval*.

(g) The maximum charge that can be applied by the *Network Service Provider* in respect of *negotiated use of system charges* for the *transmission network* and/or *distribution network* shall be determined in accordance with schedule 6.3."

20. Sithe's case that cl.5.5(h) directly imposes a new, "stand alone" obligation on a DNSP to "pass through" Avoided TUOS to an Embedded Generator independently of any agreement between them is superficially attractive when the clause is read literally, separately from its context. Sithe pointed out that Chapter 5 is not only concerned with connection agreements but also deals with other aspects of connection relationships and applies in some circumstances despite existing connection agreements and other connection arrangements: eg, cll.5.2.2(a) and 5.2.2(b)(2). It was submitted that cl.5.2.2(b) is not expressed exhaustively and does not expressly limit the application of the Code to the transactions referred to but, properly understood, extends the operation of the Code to those transactions even when one of the parties is not a Code Participant. Clause 5.5(h) was contrasted with other clauses of the Code such as cl.5.5(f), which expressly states what is to be included in connection agreements, and cl.5.4.1 which expressly limits cl.5.4 "Design of Connected Equipment" "to new installations and modifications to existing installations after this Code first applies".

21. However, although Chapter 5 also covers other matters, cl. 5.5 is one of a series of provisions in that chapter that "[provide] the framework for connection to a transmission network or a distribution network" by "[detailing] the principles and guidelines governing connection and access to a network", "[establishing] the process to be followed by a Code Participant to establish or modify a connection to a network" (cll.5.1.2(a) and (b)) and requiring that "[t]he terms and conditions on which connection to a network and provision of network service is to be granted are to be set out in a commercial agreement on reasonable terms entered into between a Network Service Provider and other Code Participants" (cl.5.1.3(b)). When it is construed in context, including earlier parts of cl.5.5, cl.5.5(h) is plainly concerned with the content of future connection agreements (or perhaps future modifications to existing agreements), not with altering the rights and obligations of parties to existing agreements which do not enter a new connection agreement (or perhaps modify an existing connection agreement) after cl.5.5(h) came into effect.

22. Clause 5.2.2(c) reinforces that conclusion. If cl.5.5(h) was given its full literal effect, unqualified by the context, an obligation on a DNSP under cl.5.5(h) to pass through Avoided TUOS to an Embedded Generator would alter the contractual rights and obligations of any DNSP and Embedded Generator that are parties to a connection agreement to which the Code applies that existed when cl.5.5(h) was amended under which the DNSP is entitled to be supplied with electricity in return for payments prescribed by the connection agreement. Had it been intended that cl. 5.5(h) was to alter contractual rights and obligations existing at the time the clause was introduced, one would have expected to find an express provision stating that the clause was to have this effect.

23. Question 1 should be answered "No".

24. The Panel's attention was drawn to cll. 8.2.5 and 8.2.6B(c) of the Code and the Panel was asked to consider whether a further notification to the market is required. The market notification given pursuant to cl.8.2.5(e) of the Code stated that this dispute concerns the "application of Code provisions concerning the pass through of Customer TUOS usage charges". No Code Participant other than Sithe and Integral has given notice to the Panel that it wishes to become a party to the dispute.

25. Clause 8.2.5 (e) provides:

> "(e) Where the Adviser refers a dispute to a DRP, the Adviser must promptly publish to all Code Participants the fact that the referral has been made."

26. Clause 8.2.6B(c) provides:

> "(c) Any Code Participant that has an interest in a dispute may opt to become a party to the dispute by giving notice to the DRP that it wishes to do so. When a Code Participant opts to become a party to the dispute in accordance with this clause 8.2.6B(c), the DRP must give that Code Participant's DMS Contact written notice setting out: …..".

27. The Panel is satisfied that Code Participants would have been aware that the construction of cl.5.5(h) was likely to be in issue from the description of the dispute in the market notification that was given

and considers that the notification was adequate. It is, of course, important that the description of a dispute in the market notification should be in such terms as to bring the nature of the dispute to the attention of Code Participants and enable them to form a view as to whether their interests may be affected. The market notification in this case did that.

28. The parties are invited to provide written submissions within 14 days with respect to costs, publication of the decision including any issue of confidentiality and any other orders required or other matters.

DATED 8th January 2003.

Sir Anthony Mason

G E (Tony) Fitzerald

Philip Williams