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Elisabeth Ross Project Leader Australian Energy Market Commission PO Box A2449 Sydney South NSW 1235

Lodged electronically at: www.aemc.gov.au

Dear Ms Ross

# ERC1011: Consultation Paper - National Electricity Amendment (Scale Efficient Network Extensions) Rule 2010

Ergon Energy Corporation Limited and Ergon Energy Queensland Pty Ltd (Ergon Energy) welcome the opportunity to provide comment to the Australian Energy Market Commission's Consultation Paper on Scale Efficient Network Extensions (SENE).

Ergon Energy has provided a response to each of the questions raised in the Consultation Paper as well as general comment on the proposed SENE Rule change.

Should you wish to discuss any aspect of this submission, please do not hesitate to contact me (07) 4121 9545.

Yours sincerely

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**Group Manager Regulatory Affairs** 

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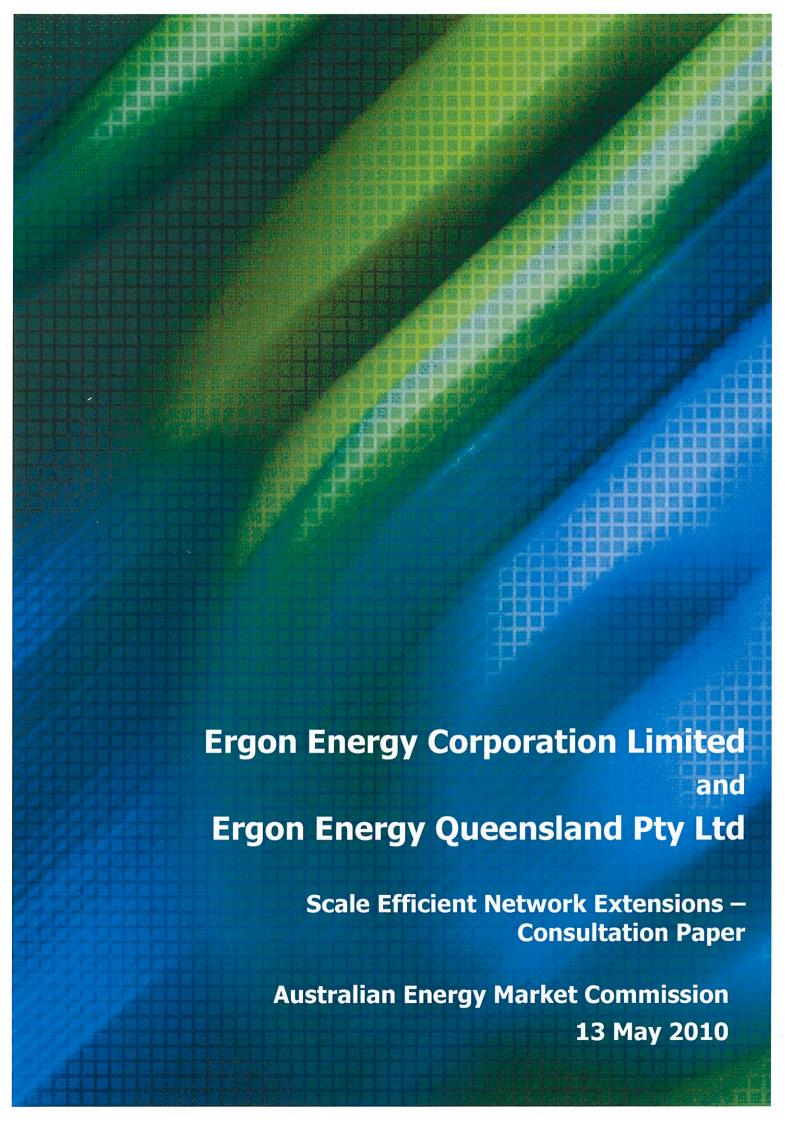
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# Scale Efficient Network Extensions Consultation Paper Australian Energy Market Commission 13 May 2010

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### 1 INTRODUCTION

Ergon Energy Corporation Limited (EECL) and Ergon Energy Queensland Pty Ltd (EEQ) welcome the opportunity to provide a submission on the Australian Energy Market Commission's (AEMC) Consultation Paper – National Electricity Amendment (Scale Efficient Network Extensions) Rule 2010 (Consultation Paper).

This submission is provided by:

- EECL, in its capacity as a distribution network service provider in Queensland; and
- EEQ, in its capacity as a non-competing area retail entity in Queensland.

In this submission, EECL and EEQ are collectively referred to as 'Ergon Energy'.

Ergon Energy is available to discuss this submission or provide further detail regarding the issues raised, should the AEMC require.

### 2 GENERAL COMMENT

While Ergon Energy supports the AEMC's consideration of amendments to the existing Rules to allow consumers to benefit from the scale economies associated with larger network assets supporting generation clusters, Ergon Energy firmly believes that additional analysis and consultation is required before the Scale Efficient Network Extensions (SENE) framework proceeds to a Draft Rule Determination.

In particular, there is the need for the AEMC to undertake a more detailed consideration of:

- whether there is evidence that inefficient duplication of connections assets is occurring or likely to occur;
- permissible models for SENE development (i.e. SENE configurations);
- the interaction of SENE cost recovery with the classification of services and charging arrangements under Chapters 6 and 6A of the Rules;
- mechanisms for ensuring that consumers do not bear a disproportionate level of risk due to asset stranding; and
- the increased integration of the allocation of capacity into the NEM dispatch process.

Ergon Energy is concerned that, on the basis of the proposal as developed, there is a significant risk that the assumed benefits of SENE will not materialise or will be outweighed by the costs imposed on customers. Rule changes should not be settled until such time as the AEMC, participants and interested parties are fully informed of the options for addressing these issues and their implications for the existing wholesale market and network regulatory arrangements.



### 3 RESPONSE TO AEMC QUESTIONS

# Question 1: Will the proposed framework improve efficiency in the construction of connection assets?

Ergon Energy recognises that the current regulatory framework provides little incentive (and is likely to penalise) NSPs for building assets to a scale that accounts for future connection commitments. Amendment of the planning and connection framework in the manner proposed may therefore assist in encouraging the establishment of generation clusters over time and in doing so, avoid the duplication of assets and reduce overall costs to consumers and generation proponents.

However, as noted above, further analysis and consultation is required before the SENE framework can be said to deliver on the goal of improving the efficiency in the construction of network assets.

# Question 2: Will SENEs be efficiently sized and located so as to minimise risk to consumers?

### Allocation of Risk

Ergon Energy considers it paramount that the proposed framework does not result in consumers bearing a disproportionate level of risk. In particular:

- a SENE should only be implemented in circumstances where the likelihood of further generator subscription, consistent with the forecast generation profile, is high. Rather than a commitment by a single generator as being adequate for a SENE to progress to investment stage this should be based on a reasonable percentage of the capacity of a SENE being subscribed (e.g. 30%); and
- penalties should apply to generator connection applicants in circumstances where a generation project is abandoned following acceptance of the connection offer or where commissioning is delayed due to generator fault or choice (e.g. financial optimisation). NSPs should be able to request prudentials sufficient to ameliorate this risk.

### **SENE Charges**

In relation to the proposed SENE charging arrangements, Ergon Energy comments that:

a SENE will be characterised as a negotiated transmission service or negotiated distribution service, with customers required to, fund the shortfall between generator contributions and the NSP's annual revenue requirements, or receive any surplus recovered for the SENE (rule 5.5A.1). Ergon Energy's Distribution Determination for the next regulatory control period (commencing 1 July 2010) will not include any negotiated distribution services. Ergon Energy queries how it would be proposed to impose a new service classification on an NSP without reopening the NSP's Distribution Determination mid-period (which should be avoided);



- all amounts chargeable or refundable to customers must be allocated by the relevant Co-ordinating SENE NSP to transmission network users and transmission network connection points in accordance with the NSP's pricing methodology (rule 5.5A.15). It is unclear however whether the Rules permit NSPs to recover or refund revenue related to negotiated services from (or to) standard control service customers and how this would comply with an NSP's pricing principles under the Rules;
- clarification is required regarding the treatment of connection assets under the
  proposed framework. In the next regulatory control period, the design and
  construction of new large customer connection assets will be an alternative control
  service in Queensland and as such, will be open to competition, i.e. design and
  construct may be undertaken by the connection applicant, at the connection
  applicant's election. In circumstances where design and construct activities are
  undertaken by Ergon Energy, charges will determined by a formula approved by
  the Australian Energy Regulator (AER), and payable prior to work commencing;
- a shortfall in SENE charges in 'any year' may be recovered from customers 'during the following year' (rule 5.5A.13(i)). The method for recovering the shortfall is not specified and the period allowed may not be sufficient to determine the quantum of the shortfall to be recovered. If an 'under and overs' process is proposed, recovery in the following year would be inconsistent with the two year time period currently permitted;
- given that the increased penetration of generation, in particular renewable generation, has market-wide (i.e. NEM-wide) benefits, it may be appropriate to consider the recovery of SENE charge shortfalls across all NEM consumers, rather than solely from those in the region where the SENE is being developed. It is acknowledged however that the administrative complexities of expanded cost recovery would need to be carefully weighed against its benefits; and
- it is unclear whether the 'pricing methodology' referred to under rule 5.5A.15(f)(2) is to be prepared by the Co-ordinating SENE NSP or the appointing SENE provider. If this is intended to apply to the appointing SENE provider then the definition of 'pricing methodology' in Chapter 10 of the Rules will need to be expanded.

Further consideration is required of the interaction of the SENE charging arrangements with the provisions of Chapter 6 of the Rules.

### Question 3: Are alternative risk mitigation measures more appropriate?

Ergon Energy supports the inclusion of an explicit economic efficiency test, akin to the existing regulatory test (for distribution investment) and RIT-T (for transmission investment). The benefits accruing to consumers as a consequence of the SENE should be clearly demonstrated under this test.

With regards to developing generation forecasts and profiles, AEMO (and not NSPs) would be in a far better position to determine the economic benefits, risks and costs to customers as well as forecasting new generation for SENEs.

Additional regulatory interventions (e.g. explicit incentive schemes for DNSPs) are not supported at this time.



The alternative of a market-based approach for the sizing and location of SENEs suggested in the Consultation Paper is not preferred on the basis that:

- generators, as competitors, would not be sharing information on the location, size and timing of future generation plant; and
- since the value of the options would only represent a small proportion of the total
  cost of the SENE, it could allow generators to purchase options for the right to
  contract for capacity for a relatively low cost. This could be open to manipulation
  by some generators as a means of impeding competition from other generators,
  leading to inefficient outcomes on the timing of new generation in the NEM.

# Question 4: Will generators be able to connect to the SENEs in the most efficient configuration?

A SENE is likely to be developed over time with the timing of capacity increasing and the location of connection points being matched to the expected connection of generators in the SENE zone. This may also see the location of the SENE hub move over time as the SENE is extended to enable the connection of more remote generation sites at a later date. This would be a prudent and efficient approach to the development of a SENE.

Restricting the SENE to a 'hub and spoke' model would appear to be inconsistent with the notion of SENE development over time and is likely to lead to inefficient network and generation investment decisions.

Further investigation is therefore required of how SENE charges can be developed under a network model. While a simple \$/MW charge may work with under a hub and spoke configuration, it is unlikely to produce an equitable charge for a more complex or evolving configuration.

### Question 5: Will capacity be efficiently allocated to connecting generators?

### **Connection of New Generation**

With regards to the Consultation Paper's proposed options for allowing the connection of additional generation, Ergon Energy supports option one (generator funding augmentation), as this reflects the principle that SENE generators are required to fund the full economic cost of their connection.

The second option (allowing a new generator to connect to a fully utilised SENE and make compensation payments) is not supported as this may adversely impact the existing generators' operating profiles and fuel contracts as a consequence of the non-firm operating profiles of new generators connecting to the SENE.

The third option (allowing a new entrant to negotiate directly with incumbents to purchase a portion of their power transfer capability) is also not supported for reasons similar to the second option, namely the complexities involved in capacity allocations and 'off-market' compensation.



### **Allocation of Capacity**

Should the proposed SENE rule changes continue to allow for the connection of additional generation to the SENE once the capacity of the SENE is fully utilised then consideration should be given to the allocation of SENE capacity through the existing NEM dispatch process, in strong preference to the introduction of capacity entitlements and associated 'off-market' compensation arrangements administrated by NSPs. This would involve using AEMO's established scheduling and dispatch processes to:

- limit the output of SENE generators to their contracted power transfer capability;
   and
- manage the allocation of capacity as new generators connect to the SENE. That
  is, the imposed maximum capacity of new generators connecting to the SENE
  would be based on the lesser of the remaining SENE capacity and the new
  generators' installed capacities.

The allocation of initial and new capacity through the NEM dispatch process, managed by AEMO, would ensure that power system security is maintained and that central dispatch is not distorted, particularly as additional connection points are established over time.

While it is recognised that some generators may not currently be captured within AEMO's scheduling and dispatch process by virtue of their registration and classification (e.g. the registration of small generators as non-scheduled), AEMO should be charged with consideration of the way in which the scheduling and dispatch framework can be modified to capture small generators within a SENE. It is suggested that this work should occur in consultation with industry through AEMO's Small Generator Reference Group.

### Compensation

In accordance with its views above, Ergon Energy does not support the proposed compensation framework being administered by NSPs as outlined in draft rule 5.5A.14. In particular, Ergon Energy believes that further investigation is required to identify the party best placed to calculate, collect and make payments in circumstances where a generator is constrained off during a trading interval.

While the Rules as currently drafted require NSPs to settle these arrangements, NSPs do not have established systems and processes for the administration of compensation, or access to data underlying its calculation. The inclusion of concepts such as 'trading amount' within the compensation calculation and the need to undertake this calculation on a trading interval basis, will necessarily require NSPs to access dispatch and settlement data. For example, based on the definitions in the Rules, it is understood that in calculating the additional trading amount a generator would have otherwise received will require a NSP to capture spot market, ancillary service and reallocation transactions.

It is also envisaged that the calculation and administration of compensation will become increasingly complex over time as the SENE becomes more integrated into the NEM through 'looped' or 'grid' configurations, rather than under a simple linear arrangement.

Ergon Energy believes that more detailed consideration is required to examine the practicalities for NSPs in administering this arrangement. For example:

• the extent to which payments would need to be revised over time as the amount that the generator would otherwise have received changes over time in response to revisions (e.g. settlement revisions and market events); and

 while the reasonable costs of administering this arrangement can be retained under the proposed Rules, it is unclear how NSPs would recover the significant costs of establishing supporting systems and processes.

Ergon Energy believes that AEMO is better placed to manage the data and calculations associated with the proposed compensation arrangements as it possesses the necessary core data.

### Interruptible Generation

Explicit conditions should apply the connection of interruptible generators (such as wind and solar) to the SENE to avoid gaming and ensure that there is an equitable allocation and full recovery of SENE costs. For example, the Rules could provide for interruptible generators to pay charges based on the lesser of:

- · the capacity remaining on a SENE; and
- a percentage (e.g. 75%) of their registered capacity.

# Question 6: How could loops to the shared network and load connections to SENEs best be accommodated?

As noted in the Consultation Paper, the draft Rule does not appear to address the potential for SENEs to become difficult to distinguish from the shared network. Ergon Energy believes that the framework for capacity rights and their duration must be developed with recognition that:

- as the network develops, it may be optimal for a SENE to have more than one connection point to the shared network or for the generation configuration within the SENE to change; and
- load is likely to connect to the SENE, both initially (e.g. load imported by the generator to run auxiliaries, maintenance start up and workers' accommodation) and over time as loads external to the generator are established (e.g. local communities).

Further to this, Ergon Energy does not support the 'ring fencing' of SENEs by preventing additional connections to the shared network, either indefinitely or for a stipulated period, as this would be inconsistent with the principle of open access, represents a market intervention and is likely to be contrary to the efficient development of the network.

