



13 May 2010

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear John,

SENE Rule Change Consultation Paper

SP AusNet welcomes this opportunity to comment on the Commission's Consultation Paper on the National Electricity Amendment (Scale Efficient Network Extensions (SENEs)) Draft Rule. The Commission's paper raises some important questions and challenges for the connection of remote generation to the existing transmission and distribution networks.

SP AusNet supports the development of a regime to facilitate the achievement of the 2020 expanded Renewable Energy Target (RET) where it is consistent with efficient investment in generation and electricity networks. A SENE-type regime, if designed appropriately, has the potential to address any first mover disadvantage in generation connection and prevent the inefficient duplication of network assets by 'future proofing' network investments. However, it is important that any future SENE regime should not compromise the effective operation of the existing regulatory framework or crowd out market-led solutions.

This submission responds to elements of the proposed regime which require further consideration, including maintaining consistency with the existing regulatory framework, and preserving contestability arrangements in Victoria. As a member of Grid Australia, SP AusNet also supports the views in Grid Australia's submission.

We would be pleased to respond to any queries that you may have on this submission, and look forward to participating constructively throughout the SENE rule making process.

Yours Sincerely

Signed Patrick Murphy
ACTING DIRECTOR REGULATION AND NETWORK STRATEGY

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1. Introduction

In 2009 the AEMC completed its Review of Energy Market Frameworks in Light of Climate Change Policies ('climate change review') and provided a set of recommendations to the Ministerial Council on Energy (MCE) which included a proposal to introduce a SENE regime. Following the MCE's acceptance of this recommendation, the MCE submitted a rule change proposal to implement a SENE regime, which the AEMC published for consultation on 1 April 2010.

The proposal seeks to implement special arrangements for extending the existing transmission or distribution network to connect new clusters of generation to allow economies of scale to be captured. The proposal seeks to address the following problems identified by the AEMC in its climate change review:

- the potential deterrent to new sources of generation due to:
 - entry generators having to face the up-front cost of network extensions where the connection is remote to the existing network; and
 - the ability for subsequent generators to 'piggy back' off this initial investment (also known as the 'first mover disadvantage'); and
- the potential for inefficient duplication of network assets due to initial generators not being willing to bear the financial costs of extensions which provide greater capacity than they require, but where the network extension is of insufficient capacity to service future generation at that location.

The concept of a SENE was developed to address the above problems. It is proposed that under this special category, the asset could be oversized to accommodate expected future generation and the risk of under-utilised capacity would be underwritten by consumers. SENEs are considered necessary for the achievement of the expanded RET which requires investment in renewable generation which may be remote from the current transmission and distribution networks.

This submission identifies elements of the proposed SENE arrangements which will impact the existing regulatory framework and Victoria's contestable approach to transmission investment. The submission provides suggestions to address identified inconsistencies between the proposed SENE rules and the contestability arrangements in Victoria. Each of these matters is addressed in turn below.

2. Consistency with the existing regulatory framework

Where a SENE or similar regime is found necessary to facilitate network extensions to new generation areas, any new rules to implement the regime should be consistent with the existing features of the existing Rules as far as possible to maintain regulatory certainty and stability. Further, any incremental changes made to the rules should be proportional to the problems they are seeking to address. SP AusNet is concerned that there are a number of problems with the draft rule as currently designed, including the

creation a new category of services which appear to blur the line between negotiated and prescribed services. SP AusNet is also concerned that this may impact the transmission planning arrangements in Victoria.

Categorisation of assets and services

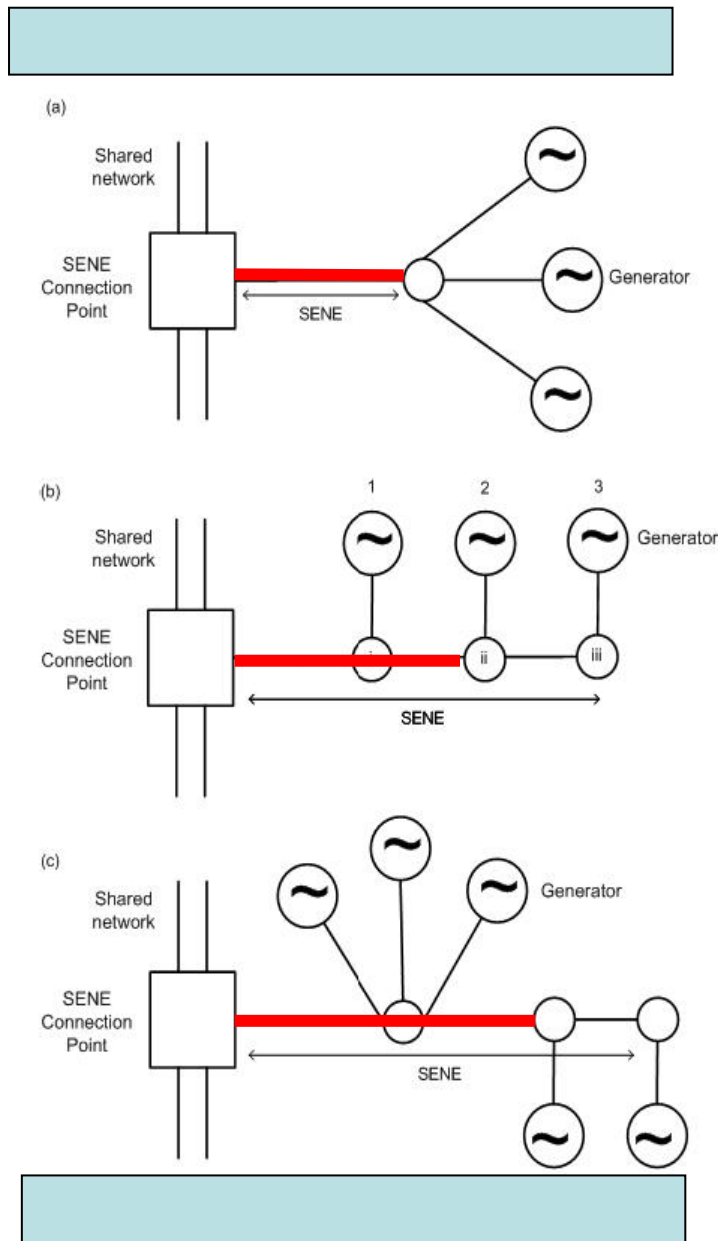
The proposal's approach to classifying the services provided by a SENE creates a new service category, introducing complexity into the regulatory framework which SP AusNet considers should be avoided.

The draft rule states that SENEs are part of the network (and not connection assets) but should be treated as providing 'negotiated connection services' under the umbrella of 'generator transmission/distribution use of system services.'¹ SP AusNet notes that 'negotiated connection services' is not a defined term under the rules and that generation connection is contestable under the existing framework.

While the proposal describes SENEs as negotiated services, the fact that SENEs would be subject to direct price regulation indicates that they would not fit comfortably in the negotiated services category.

Further, the AEMC's SENE configuration diagrams indicate that the services provided by a SENE appear to be shared in nature which would, under the existing framework, be categorised as providing shared transmission services, rather than connection services. The SENE would provide a connection service if only one generator was connected to the shared network via the SENE, however, over time as other generators connect onto the SENE, it will become more interconnected with the shared network. SP AusNet is of the view that artificially 'ring-fencing' SENEs from the rest of the shared network not only creates undesirable complexity in the classification of services, but may also inhibit efficient generation investment. SP AusNet has used the configuration diagrams in the AEMC's Consultation Paper to illustrate this below, with the shared network service component being highlighted in red.

¹ Appendix A: Draft Rule for connecting generation clusters, p 27



SP AusNet notes that the categorisation of SENE assets may also impact Victoria's jurisdictional arrangements given the roles and responsibilities for planning and operating the declared transmission network are divided between asset owners (including SP AusNet) and AEMO. SP AusNet encourages the AEMC to take account of these arrangements in progressing its rule change process, and clarify the roles and responsibilities of AEMO and asset owners in Victoria in relation to SENEs in any further rule drafting.

Capacity rights

The proposed creation of capacity rights under the SENE framework is concerning as it is inconsistent with the existing approach, particularly given the apparent shared nature of the SENE service. The creation of capacity rights in the SENE context represents a significant change to the regulatory framework which would have wide-ranging implications for the energy market. Given that the issue of capacity rights for transmission in general will be subject to a wider review of transmission by the MCE later this year, SP AusNet would urge the AEMC to exclude the concept of capacity rights from the SENE framework until the wider review is completed.

Alternative approach

The Rules should allow market-led development of extensions to the network where possible, and any regulated SENE framework should not crowd out market-based solutions. SP AusNet believes that market-led arrangements protect consumers from unnecessarily underwriting inefficient investments. SP AusNet refers the AEMC to the examples of market-based approaches outlined in Grid Australia's submission as possible alternatives to the SENE framework.

3. Contestability in Victoria

A contestable approach applies to transmission network investment in Victoria. This requires AEMO to go to market (in certain circumstances) to seek tenders for the construction of network assets and associated services. AEMO has indicated that it would continue to apply contestability to investments made under the SENE arrangements. As such, it is important that any SENE regime be designed in such a way that contestability in Victoria can be preserved and accommodated.

SP AusNet has identified certain aspects of the proposed SENE rule which would prevent the application of contestability in Victoria. These are:

- the role of the AER in approving costs contained in SENE connection offers given that they have been determined through a contestable process;
- the inability for successful tenders to receive the return determined appropriate through a contestable process given that the rate of return on SENEs is predetermined to be regulated WACC; and
- the required regular revision of SENE charges to align with actual costs given that a contestable process will mean AEMO will have a long term (20-30 year) contract with the successful tenderer.

Possible means to address these conflicts are to include provisions in the Rules which allow for:

- the AER to automatically approve SENE connection offers determined through an AEMO contestable process for extending the declared transmission network;

- a further category for an appropriate rate of return in addition to one which reflects the regulated WACC, that is, a rate of return which has been determined through an AEMO contestable process for extending the declared transmission network; and
- an exemption for the required regular revision of SENE charges to align with actual costs where a long term (20-30 year) contract exists between AEMO and a service provider as a result of a contestable process for extending the declared transmission network.

SP AusNet would be happy to work with the AEMC and AEMO to explore these options further. Without similar provisions, it appears unlikely that contestability would be unable to be applied in Victoria in relation to these types of investments. However, for the purposes of transparency it is crucial that should SENEs be subject to contestability in Victoria, AEMO should commit to applying contestability early in its investment project processes so that the contestable process compromised.

4. Conclusion

While SP AusNet supports the concept of a SENE (or a similar last resort style investment mechanism) in principle, there are aspects of the proposed rule which require reconsideration because they:

- may compromise the effective operation of the existing regulatory framework, particularly the categorisation of assets and services and the treatment of capacity rights; and
- are inconsistent with the contestability framework which applies to transmission investments in Victoria, given the network planning and procurement arrangements in that jurisdiction.

In light of this, the MCE's rule proposal may not be the most appropriate means of addressing the above challenges. Further, SP AusNet considers the opportunity for market-led arrangements for the development of network extensions should be allowed to work where possible and considers that these should not be inadvertently crowded out by a SENE. Only where market-led approaches are insufficient to provide for necessary investment should the concept of a SENE apply.