



SUBMISSION ON

**"ELECTRICITY
DISTRIBUTION:
DETERMINATION OF
PRESCRIBED SERVICES"**

14 JULY 2000

INDEX

	Executive Summary	2
1.	Introduction	3
2.	Relationship between the Qld E/Act (& Regs) and the NEC.....	3
3.	Customer's Expectations of a Distribution Network Service Provider	4
4.	Comment on the QCA's "thinking"	5
5.	Comment on the QCA's Approach	6
6.	Comments on the Description of Services that should be Prescribed or Excluded	11
7.	Appendix A –Definitions drawn from the E/Act & NEC	12

EXECUTIVE SUMMARY OF KEY ISSUES

This document is the Ergon Energy submission to the Queensland Competition Authority in response to the Discussion Paper titled:

"Electricity Distribution: Determination of Prescribed Services"
dated June 2000

The significant points that Ergon Energy has developed and presented in this submission are summarized below:

- ➊ Ergon Energy is generally supportive of the approach proposed by the QCA ie. that all services are "prescribed" at the outset, and may become "excluded" following application by a DNSP and meeting certain qualifying tests.
- ➋ Ergon Energy is proposing an extension of the parameters of "excluded" services to include circumstances where particular types of customers seek to vary the "standard regulated offer".
- ➌ Ergon Energy is vigorously arguing that there needs to be clear and positive consideration of the Queensland legislative and other regulatory arrangements when assessing applications for declaration of "excluded" services. Failure to do so will effectively prevent the DNSP from participating freely in the market for those "excluded" services.

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1.0 Introduction

The QCA has sought submissions from interested parties re:

- (a) The Authority's "thinking" with respect to the determination of prescribed services for Distribution Network Services Providers.
- and
- (b) The Authority's approach adopted.
- and
- (c) The definition of services that should be prescribed or excluded.

Ergon Energy will address each of these issues in the following submission.

However we think it relevant to firstly outline circumstances which have evolved in recent times with respect to the relationship between the Queensland electricity legislation and the National Electricity Code (including various legal advices obtained by Ergon Energy) and customers' expectations of a Distribution Network Service Provider (DNSP).

2.0 Relationship between the Queensland Electricity Act & Regulations (E/Act & E/Regs) and the National Electricity Code (NEC)

- 2.1 Ergon Energy has obtained a detailed legal advice with respect to the hierarchy of electricity legislation. In particular, we sought to clarify the issue of conflict between the E/Act and the NEC (including matters where the NEC was "specific" and the E/Act was "broad").
- 2.2 In summary the advice states that Ergon Energy must comply with both the E/Act and the NEC and there are in fact different regulators (Department of Mines and Energy and Queensland Competition Authority) for the purpose of resolving disputes and ensuring compliance with obligations.
- 2.3 The advice also states that Ergon Energy is bound to comply with both the E/Act and the NEC (as a Code Participant) and that it is entirely plausible and *"likely that some very difficult questions of statutory interpretation will arise"*.
- 2.4 The lawyers' interpretation is that in practice, the NEC will govern arrangements between Ergon Energy and other Code Participants and that the E/Act will continue to govern arrangements between Ergon Energy and customers & others in the general sense.

Ergon Energy's experience is that as a class, Generators and, to a limited extent, Retailers, are the only true Code Participants with whom we deal for network issues and between whom the NEC processes and obligations apply. Large customers, whilst probably meeting the definitions of Intending

Participant or Customer, do not, or rarely, actually register with NEMMCO in those capacities.

2.5 They key issue is: There is an obligation for Ergon Energy to comply with both the E/Act and the NEC, and these obligations can not be dealt with in isolation from each other.

2.6 Ergon Energy's obligation under the E/Act to provide "customer connection services" under S40, and the definitions of "Network services", "Works", "Electrical Installation" and "customer connection services" are particularly relevant because they are not NEC or generic terms, but rather are Queensland terms and define the positive obligations on DNSPs operating in the Queensland environment.

Likewise, the definitions under the NEC of "distribution services", "prescribed distribution services" and "excluded distribution services".

A summary of these definitions is provided in Appendix A.

2.7 Obligations under the E/Act and the definitions of "supply network" also have an impact on the treatment of electrical assets Ergon Energy may seek to build, own or purchase. As a DNSP with a "distribution area", and a Code Participant, Ergon Energy is placed in a different position to other potential players in a market.

2.8 The key issue is: That Ergon Energy is currently restrained from accessing the "market" for ownership, construction, operation & maintenance of "private" electrical assets within its distribution authority area, by nature of its status under the E/Act as a "distribution entity" with a "distribution area".

3.0 Customer's Expectations of a Distribution Network Service Provider

3.1 Chapter 5 of the NEC explicitly provides for the Connection Applicant and the Network Service Provider to "negotiate" about the arrangements between the parties. This includes negotiating about requirements, levels of service and quality of supply, prudential requirements, technical specifications, constraints, network availability, contingency plans etc.

DNSPs have also provided an Access Undertaking to the ACCC under S44ZZA of the Trade Practices Act which includes an undertaking to:

*maintain and make available its networks for access to the network services:
(a) by Code Participants in accordance with the requirements of the Code; and*

(b) by all persons in accordance with (i) applicable regulatory instruments; and (ii) good electricity industry practice and applicable Australian Standards.

- 3.2 However, under the current regime, Ergon Energy is bound to charge the price fixed by the Minister under S301 of the E/Act and to obtain the "regulated" rate of return for these services.

The rate of return is based on a 35 year asset life returning 6.81% ROA + Depreciation + O&M.

Ergon Energy matches prudential requirements accordingly ie. taking minimal risk with respect to asset stranding, the commercial standing and long-term prospects of the customer.

- 3.3 This arrangement has proven to be most unsatisfactory to some customers.

As they become more knowledgeable with respect to the NEC (which fosters the concept of flexibility and ability to negotiate), Customers are seeking variations to the "standard regulated" supply arrangements eg. to manipulate the up-front costs versus ongoing liabilities; to vary Ergon Energy's risk profile; to trade off higher prices for lower service or technical specifications; to demand higher network availability; to negotiate for compensation for economic loss.

Ergon Energy finds itself constrained from entering into negotiations with customers due to the legal and regulatory framework in which it operates.

- 3.4 **The key issue is: That customers are currently being frustrated by the constraints on DNSPs to negotiate within the parameters of the current economic regulation and their obligations under the E/Act and NEC.**

4. Comment on the QCA's "thinking"

- 4.1 In the general sense, Ergon Energy is supportive of the approach of at the outset deeming all distribution services to be "prescribed services" unless there is a determination otherwise by the QCA.

- 4.2 We are however concerned that in considering this issue, the QCA has focused on the intent and content of the NEC to the exclusion of obligations of DNSPs under the Queensland Electricity Act and their Distribution Authorities.

- 4.3 We are of the view that the principles for assessing the effectiveness of competition (Section 5 of the Discussion Paper) are flawed in that the focus is on an entity's role in the market, rather than the market itself ie. the

assessment for effective competition should be derived from looking at the market and its state, rather than the position of a particular entity participating in that market.

- 4.4 Further we are of the view that it is imperative that "competition tests" are congruent with the approach of the ACCC, the Trade Practices Act and case law. DNSP behaviors are also subject to the TPA and oversight by the ACCC and any methodology adopted must be consistent with their approach and sufficiently robust to withstand the tests at law.
- 4.5 **The key issue is: Ergon Energy is supportive of deeming all distribution services to be "prescribed" unless the QCA determines otherwise following application of recognized TPA principles for assessing the market and effectiveness of competition in that market.**

5. Comment on QCA's Approach Adopted

- 5.1 We support the principle that *"The key issue with prescribed services is that such services are both guaranteed and limited to the regulated rate of return"*. (Section 3 Para 1). This ensures that all potential users of these services in the DNSP's area receive equitable treatment and access to the network.

However we are firmly of the view that this should not be the only option available to a customer.

Our preferred approach is that this guaranteed service delivered for the regulated return, is the "standard regulated offer" to meet our obligations under both the E/Act and the NEC.

- 5.2 If a customer then seeks to vary the "standard regulated offer", the service should move out of the regulated arena, and the DNSP should have the flexibility to negotiate higher or lower levels of service, for higher or lower prices and risk arrangements over a flexible cost recovery period (ie. not over the deemed asset life of 35 years).
- 5.3 This scenario does not necessarily depend on the existence of a market or competition for alternatives to the "standard regulated offer", despite that often being the case, particularly for large players.
- 5.4 We see this circumstances being particularly applicable to greenfield sites where the customer has commercial choice regarding its connection options. Most customers who are likely to exercise choice and pressure to negotiate are large players who have sufficient commercial expertise to exercise their own judgment with respect to alternatives.

Further we advocate that the customer driven negotiated position should be contained to circumstances within a defined parameters (eg. where the customer has dedicated identifiable assets; for embedded generators not using shared network assets; true Code Participants ie. the larger end of the customer market).

5.5 The key issue is: That Ergon Energy supports prescribed services being the "standard regulated offer". However where the customer seeks to vary that arrangement, as a general principle, the negotiated arrangement becomes an "excluded service" and not subject to economic regulation nor subject to the tests of "market" and "effective competition" proposed provided the customer fits within a qualifying parameter.

5.6 With respect to the objective outlined in the Discussion Paper of *"Therefore, it is reasonable to expect that regulated entities that also provide services in competitive markets would seek to earn above regulated rates of return on those activities"* (Section 3 Para 2). Ergon Energy supports this concept. However consideration should be given by the QCA to the restraints to this outcome derived from the E/Act eg. oversight by another regulator, obligations to perform a function etc.

5.7 Ergon Energy believes a legal examination of the obligations, and the limits to those obligations, of DNSPs under the E/Act should be carried out, and if necessary a legislative change occur, prior to any determinations of "excluded distribution services" for circumstances similar to the above.

5.8 The key issue is: The declaration of services to be "excluded distribution services" to allow a competitive market to operate, allows everyone except the DNSP to participate freely in that market.

5.9 Our comment on *"providing a clear set of operational guidelines that must be satisfied prior to services being granted excluded status"* (Section 3 Para 3) is that we support a set of guidelines.

Once the guidelines have been published, we would anticipate that any changes to the guidelines would only be made following an appropriate consultation process with affected parties, and that variations would not be retrospective.

5.10 The key issue is: Ergon Energy supports a clear set of operational guidelines (including a process for amending the guidelines) and seeks to provide comment on a draft when it is prepared.

5.11 Section 3 Para 4 states: *"Initially, all services performed by each DNSP that are associated with, or ancillary to, access to that DNSP's network for the supply of electricity within that DNSP's service area will be prescribed. DNSP's may then apply on a case by case basis to have specific activities treated as excluded services. This places the onus on the DNSP to provide the Authority with the evidence required to justify the exclusion of specific services."* Our comments are below (5.12 - 5.15).

5.12 We assume that the reference to "Initially" indicates that this is a commencing position until such time as an application is made to the QCA for a particular service to be excluded.

We are unclear whether there is a regular review date proposed. If that is the intention we seek your further comments regarding when, how, by whom, and the participation required of the DNSPs.

5.13 A strict reading of the words in this paragraph indicates that DNSPs are the only entities who may apply to the QCA for a declaration of an excluded service.

We seek your confirmation that this is the position.

5.14 Further, a DNSP may only apply for a service to be an excluded service in its own Distribution Authority area (ie. Ergon Energy could not seek to have a prescribed service declared excluded in Energex's area).

We seek your confirmation that this is the position.

5.15 The concept discussed of the DNSPs applying on a case by case basis is not entirely clear to us.

In addition to the individual customer driven variation to the "standard regulated offer, we support the concept of the DNSPs applying case by case for an excluded service for a class of activity based on for example, asset type but are opposed to applying case by case per customer.

Our experience is that the timeframes during negotiations with customers require a swift and firm response from DNSPs, and it simply would be unworkable to delay a deal to engage in a process of individual approvals by the QCA.

5.16 Section 3 Para 5 states:

"The approach to determining whether services will be classified as prescribed or excluded services will be to:

- *"determine whether competition exists and if so, the extent of competition in the provision of the distribution service;*

- *if competition is found to exist and to be effective, the service will be defined as an excluded distribution service, and will not be subject to economic regulation;*
- *if competition is found to exist but is not deemed to be effective, the service will be defined as a prescribed distribution service, but will be examined to determine if it should be subject to a more light-handed form of economic regulation than CPI – X; and*
- *if competition is not found to exist, the service will be defined as a prescribed distribution service and will be subject to economic regulation by the Authority under the provisions of the Code.”*

Our comments are below (5.17 – 5.23)

5.17 Ergon Energy's primary point of concern is regarding whether the competition test and subsequent classification of prescribed or excluded services relates to:

- all of Queensland
- all of an LSNP's Distribution Authority area
- part of a DNSP's area

ie. the description of the market. The resolution of this issue is crucial to the competition assessment.

5.18 With respect to the 2nd and 3rd dot points, Ergon Energy is of the view that competition can be transient between being "effective" and "ineffective" and this is dependent on a whole range of market forces, and with respect to electricity distribution services in Queensland, is particularly dependent on the legislative framework.

The recognized and appropriate test is not whether competition is effective, but rather is whether the arrangement would "substantially lessen competition" in the market. This is consistent with the approach of the ACCC, TPA and case law. Note also, that the converse argument (arrangement "substantially increasing competition") does not apply.

5.19 Further with respect to the 2nd and 3rd dot points - if a service is prescribed, it is unlikely to have attracted competition and the hence effectiveness is unquantifiable BUT if it is excluded and found to be ineffective does the service revert to some as yet undecided form of economic regulation, or will it be allowed to continue to operate in a commercial fashion ?

5.20 We are unclear what the QCA is proposing under the 3rd dot point as "more light-handed form of economic regulation than CPI-X".

5.21 We are of the view that the test should be simply as outlined in 5.18 above and whether a declaration of excluded service is fair for customers and for all potential providers (and in particular does not disadvantage the DNSP in view of the Queensland legislation, its social obligations and provider-of-last-resort default position).

5.22 We are unclear regarding the detail of the process to be adopted by the QCA in managing applications for an excluded service.

Once the criteria has been finalised (ie. consideration of the legislation, competition tests, public benefit assessments etc etc) we would advocate publication for comment of:

- (a) Suite of forms to be completed by the applicant DNSP.
- (b) Schedule of timeframes for consideration of matters.
- (c) Advice whether a consultation process (with whom, over what timeframe) will occur for each application – or does the QCA propose to simply make a ruling ?
- (d) Ability for a DNSP or others to appeal a declaration.
- (e) Process to amend or vary a declaration.

5.23 Ergon Energy would advocate the following as an alternative to the Summary of Methodology outlined in Section 6:

- (a) Where there is an obligation on the DNSP to provide the service, the "standard regulated offer" shall be a prescribed service (thus managing the provider-of-last-resort issue).
- (b) For a prospective declaration relating to a class of distribution service, or where the parties agree to move away from the terms of the "standard regulated offer", the service may be declared to be an excluded service, fully negotiable and not subject to economic regulation subject to an assessment under the following process:
 - (1) Define the market in which the arrangements are to be tested.
 - (2) Evaluate the legislative environment with respect to the service providers to that market (remembering that DNSPs have provided access undertakings to the ACCC re equitable access to their networks).
 - (3) Identify whether the proposed arrangement has the purpose, or has, or is likely to have, the effect of lessening competition in the market.

This involves an assessment of:

- (3.1) the nature and extent of the market;
- (3.2) the probable nature and extent of the competition that would exist in the market but for the arrangement;

(3.3) the way in which the market operates (eg. the legislative and regulatory environment); and

(3.4) the nature and extent of the lessening.

We contend that there is no natural correlation to be drawn by the QCA between an entity's influence in a market and the effectiveness of competition. The influence of an entity is only relevant to the extent that such influence has the effect of substantially lessening competition within the market. That is, you look at the market and its state, rather than the position of particular competitors.

The result of this approach also means that the same service description could be prescribed or excluded, but that the choice is customer driven. If the customer drives their selection to the market, the market participants then must compete to win the business.

5.24 The key issues are:

- **We seek clarification of whether there is intended to be regular reviews of declarations about excluded services.**
- **We seek clarification that DNSPs are the only entities who can apply for a declaration of excluded services.**
- **We seek clarification that a DNSP can only seek a declaration of excluded services for its own Distribution Authority area.**
- **We seek clarification as to the geographical area to which a declaration of excluded services relates.**
- **In addition to the customer driven negotiated outcomes, we support general declarations of excluded services on a case by case basis for "classes" of services (not for individual customers within a class).**
- **We do not support 2 levels of prescribed services (competition effective + competition ineffective) as contemplated by the 2nd & 3rd dot points in Section 3 Para 4. We believe the assessment should be whether competition exists or not. ie. We do not support an "in the middle" scenario placing some services between prescribed and excluded. Its either one or the other.**
- **We seek clarification and further consultation re the process to be followed to make an application for a declaration of an excluded service.**

- **We seek consideration of an alternative Summary of Methodology to that proposed in Section 6 of the Discussion Paper on the basis that the competition test should be consistent with the approach of the ACCC, the TPA and case law ie. that you look at the market and its state, rather than the position of particular competitors.**

6. Comments on the Definition of Services that should be Prescribed or Excluded

- 6.1 Ergon Energy supports aligning definitions of services as closely as possible to common descriptions used in the NEC and other jurisdictions.
- 6.2 Because of the extensive list of issues raised in this paper, and the uncertainty as to completeness of process for approval, Ergon Energy is not proposing to further define services we seek to be excluded in this submission.
- 6.3 **The key issue is: Our view is that priority should be given to carving a path to achieving the outcomes described in our Clauses 5.5 and 5.6, 5.7 & 5.8.**

Appendix A –Definitions drawn from the E/Act & NEC

With respect to the E/Act:

The term "customer connection services" is defined in Schedule 5 as follows:

"**customer connection services**", for premises, means-

- (a) the connection of the premises to a supply network to allow the supply of electricity from the supply network to the premises; and
- (b) the supply of electricity from the supply network to the premises.

The term "supply network" is defined in section 8 as follows:

A "**supply network**" is a system, or part of a system, of electric lines, substations and associated equipment, other than a transmission grid, for distributing electricity to customers, whether or not a generating plant is connected to it.

"**Network services**" are services for electricity transfer provided by transmission entities and distribution entities to persons connected to a transmission grid or supply network.

Examples of network services—

1. Providing electricity transfer capacity.
2. Controlling and regulating the characteristics of electricity being transferred.
3. Providing facilities to connect works of generation entities, transmission entities, distribution entities, or electrical installations of customers, to a transmission grid or supply network.

- (1) "**Works**" are anything used for, or in association with, the generation, transmission or supply of electricity.

Example of works:

Electric lines and apparatus, electrical articles, buildings, control cables, engines, fittings, lamps, machinery, meters, substations and transformers if they are used for, or in association with, the generation, transmission or supply of, electricity.

- (2) A "substation" is works used for converting, transforming or controlling electricity.
- (3) "**Operating works**" are:
 - (a) for a generation entity—the generating plant, fuel stocks, electrical and other property used for generating electricity or connecting supply to a transmission grid or supply network; or

- (b) for a transmission entity—the transmission grid and other property used for operating or managing the transmission grid; or
- (c) for a distribution entity—the supply network and other property used for operating or managing the supply network.

Example of other property used for generating electricity—

Coal handling facilities for a coal-fired power station and the land where they are situated.

The term "premises" is defined in Schedule 5 as follows:

"**premises**" includes-

- (a) a building or other structure; and
- (b) a part of a building or other structure; and
- (c) land where a building or other structure is situated.

The term "electrical installation" is defined in section 13 as follows:

- (1) an "**electrical installation**" is an electric line or electrical article installed in a place that is used for conveying, controlling or using electricity.
- (2) An electrical installation includes an additional other alteration to the electric line or electrical article.
- (3) However, an electrical installation does not include works used for generating, transmitting or supplying electricity.

With respect to the NEC:

The term ***distribution service*** is defined as:

"The services provided by a *distribution system* which are associated with conveyance of electricity through the *distribution system*. *Distribution services* include *entry services*, *distribution network use of system services* and *exit services*".

The term ***distribution system*** is defined as:

"A *distribution network*, together with the *connection assets* associated with the *distribution network*, which is connected to another *transmission or distribution system*.

Connection assets on their own do not constitute a *distribution system*".

A ***distribution network*** is defined as a *network* that is not a *transmission network*. A *network* is defined as:

"The apparatus, equipment, plant and buildings used to convey, and control the conveyance of, electricity to customers (whether wholesale or retail) excluding any *connection assets*. In relation to a *Network Service Provider*, a *network* owned, operated or controlled by that *Network Service Provider*".

Connection assets are defined as those components of a *transmission or distribution system* which are used to provide *connection services*. *Connection services* are defined as an *entry service* (being a *transmission or distribution service* provided to serve a *Generator* or group of *Generators* at a single *connection point*) or an *exit service* (being a *transmission or distribution service* provided to serve a *Transmission or Distribution Customer* or group of *Transmission or Distribution Customers* at a single connection point). A *connection point* is defined as the agreed point of *supply* established between the *Network Service Provider(s)* and another *Code Participant, Non-Registered Customer* or *franchise customer*.

- ie. **Accordingly, the installation and operation of assets by Ergon to enable the connection of a customer to the *distribution network* would fall within the definition of *distribution services*.**

Prescribed distribution services are "*distribution services provided by distribution network assets or associated connection assets which are determined by the jurisdictional regulator as those which should be subject to economic regulation*"

Excluded distribution services are "*distribution services, the costs of and revenue for which are excluded from the revenue cap or price cap which applies to prescribed distribution services*".