



10 October 2012

Australian Energy Markets Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Sirs,

**Submission on AEMC Second Interim Report on the Transmission Frameworks Review
EPR0019**

The Energy Users Association of Australia (EUAA) welcomes the opportunity to provide a submission to the Australian Energy Markets Commission's (AEMC) Second Interim Report of the Transmission Frameworks Review.

The attachment set out our response to the AEMC's proposals on changes to the Planning Arrangements, Access Arrangements and Connections and Extensions, in that order.

Yours faithfully,

Brian Green
Chairman

Attachment A: EUAA response to Transmission Framework Review Second Interim Report

1. Planning Arrangements

The AEMC has proposed changes to the arrangements for network planning. These changes include:

1. enhancing the Australian Energy Market Operator's (AEMO's) role as a developer of national plans, and in oversight of various planning reports and regulatory investment tests produced by Transmission Network Service Providers (TNSPs);
2. aligning regulatory control periods;
3. making AEMO responsible for the determination of transmission use of system tariffs; and
4. ending AEMO's role as procurer of transmission expansion in Victoria.

We agree with the alignment of regulatory controls, and making AEMO responsible for setting transmission use of system tariffs.

We are skeptical that the proposal to enhance AEMO's role in transmission planning will mean much in practice. The AEMC's proposals still leaves AEMO simply as an advisor to the TNSPs, a role which TNSPs are unlikely to embrace.

AEMO will have no executive authority to ensure that network developments follow their plans. Until executive authority to execute plans resides with AEMO, we suspect that these proposed changes will amount to little in practice.

We strongly disagree with the AEMC's proposal to end AEMO's role in procuring assets to expand the transmission network in Victoria. The essence of the AEMC's argument for this change is that the Victorian model has not delivered competitive tenders because SP Ausnet has won almost all the tenders issued by VENCORP and subsequently AEMO.

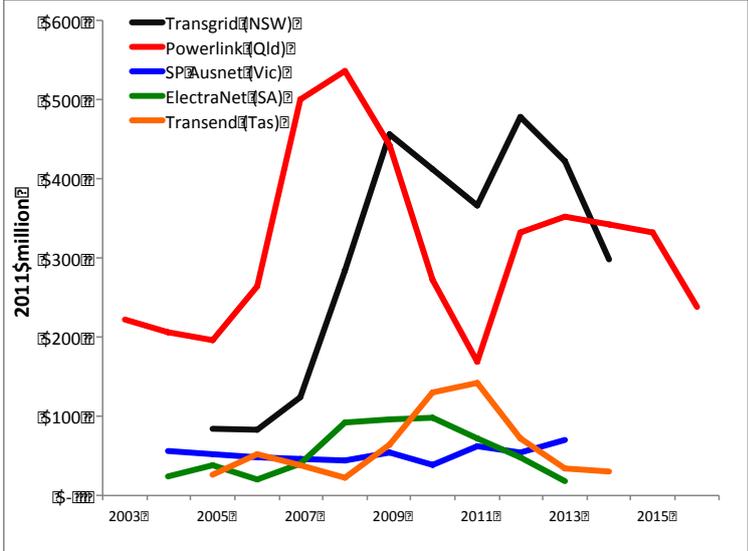
We agree that there may be scope to improve the competitiveness of the tendering process and that further benefits in the long term interests of Victoria's energy users may be possible in this area.

However, the competitiveness of the procurement process is only one, small, part of the Victorian arrangement. The Victorian arrangement for the planning and procurement of transmission expansion has, in aggregate, delivered significantly better outcomes than those in the rest of the NEM.

The evidence for this is established in a report “A comparison of outcomes delivered by electricity transmission network service providers in the National Electricity Market” that the EUAA commissioned from CME, which will be released soon. In the rest of this sub-section we set out the relevant part of their analysis, as evidence in support of our views.

The CME report examined load driven capital expenditure by TNSPs in the NEM. The level of load driven capex by the TNSPs in NEM approved by the AER (and charged to energy users) is shown in Figure 1 below.

Figure 1. Load-driven capex (2011\$million)

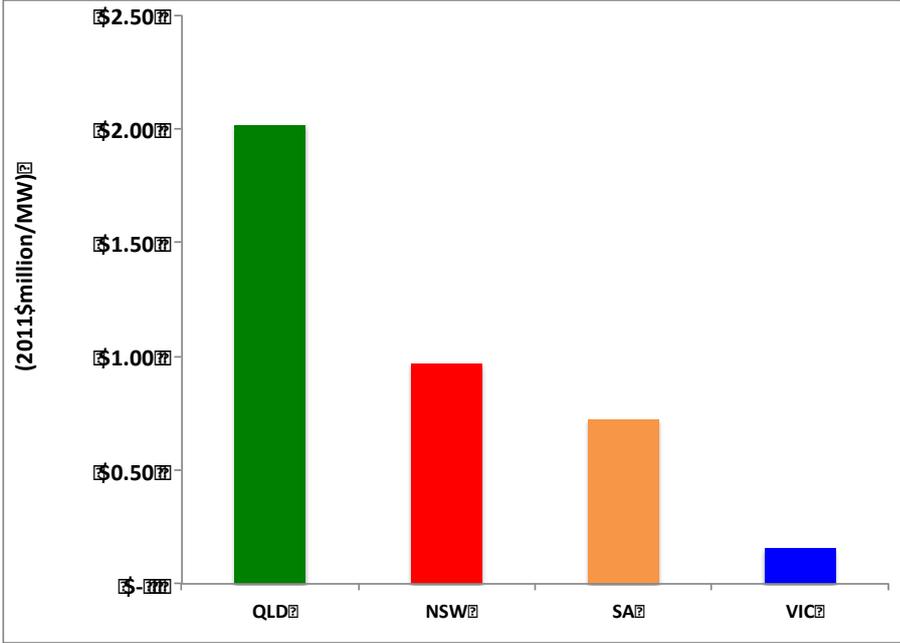


Their report then analysed the load driven capex in the context of the load growth. The result of this analysis is shown in Figure 2 which compares the average annual load growth expenditure over 10 years (except for Powerlink where 14 years of data is available), with the trend rate of growth of (annual) peak demand over this 10/14 year period.

The outcome of this analysis is the average annual load-driven capital expenditure expressed as a ratio of the average annual load growth. Transend is not shown in this chart because it has had significant load-driven capital expenditure but almost no load growth and hence its ratio (\$21m per MW of load growth) would distort the comparison of the remaining TNSPs if shown on the same chart.

Figure 2 show that - besides Transend in Tasmania - Powerlink in Queensland has the highest level of load driven capex per MW of load growth (around \$2million/MW). In Victoria on the other hand, \$0.15million of expenditure has been incurred per MW of load growth.

Figure 2. Average annual load driven capex divided by average annual demand growth



The analysis in Figure 2 reflects the average annual load driven capex per unit of *actual* load growth, not the load growth projected by the TNSPs at the time they decided to incur the expenditure. The load-driven expenditure per unit of load growth would be different if *projected* load growth, rather than *actual* load growth, was used.

It should be recognised that there are some definitional challenges in the comparison in Figure 2. For all TNSPs other than in Victoria, the annual load driven capex is based on actual load driven capex (to the end of their previous regulatory period) and the proposed load driven capex (for the current regulatory period), based on the information that the TNSPs’ provided in their revised revenue proposals to the AER. For Victoria the load driven capex is the augmentation capex that has been planned and procured by VENCORP (now AEMO).

There may be definitional differences between what is classified as “augmentation capex” in Victoria and what the other TNSPs call “load driven capex”. As such, more effort in common data definitions may suggest that the differences between Victoria and the TNSPs in other states may not actually be as large as shown in Figure 2, or indeed they may be larger. However, the gap between SP Ausnet and the others seems to be so large that even substantial definitional inconsistencies are unlikely to undermine the observation that the Victorian arrangements appear to have delivered very much lower capex per MW of additional demand, than seems to be the case for any of the other TNSPs.

The large gap begs the question whether this can be attributed to demand forecasting errors - has VENCORP/ AEMO forecast demand more accurately than other TNSPs, and hence delivered lower capex per MW of demand ?

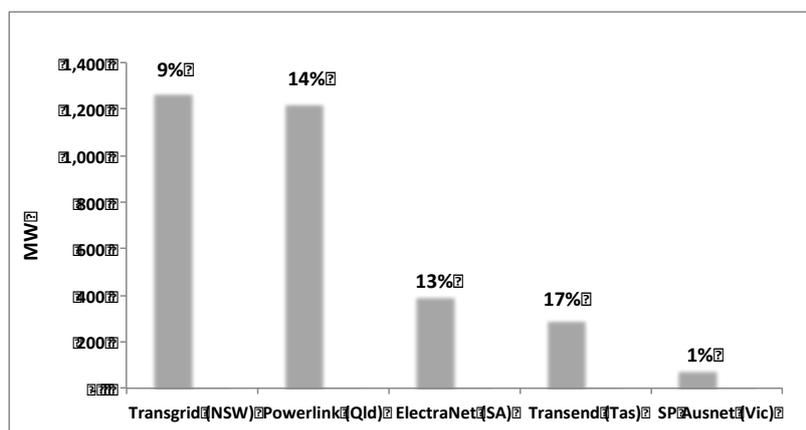
CME then analysed this and their results are presented in Figure 3. It shows the average annual difference, during the current regulatory period of each TNSP, of:

1. the peak annual demands that were projected (by the TNSPs) at the time of the AER's regulatory decisions that set the allowed revenues (and capex programs) for the current regulatory period; and
2. the actual demand (up to the year ending 30 June 2012) and AEMO's recent projection of demand (for demand after 1 July 2012).

The result shows that over the current regulatory period Powerlink and TransGrid projected actual demand to be, on average, around 1,200 MW higher than it has been and that AEMO project it will be for the remaining yeas of the regulatory period. Electranet and Transend were around 300 MW higher, and in Victoria it is around 50 MW higher. When this difference is stated as a percentage of actual 2012 demand, it ranges between 1% for Victoria to 17% for Transend.

It is clear from this that, other than for Victoria, all TNSPs seem to have systematically forecast significantly higher demand than has actually been the case. This would therefore explain part of the reason for their higher cost of load driven capex per MW of demand, compared to SP Ausnet's.

Figure 3. Average annual difference between projected and actual demand growth (MW) and as a percentage of peak demand during the current regulatory period



On the basis of this evidence, we strongly disagree with the AEMC's recommendation that AEMO should no longer have a role in procuring network augmentation in Victoria. This recommendation undoes what has perhaps been one of the most significant successes in electricity reform in Australia. If anything we suggest that the AEMC should be investigating the benefits of replicating the Victorian arrangements elsewhere in the NEM.

2. Access Arrangements

The AEMC has proposed an “optional firm access” model, which it says “*would require fundamental changes to the NEM, and this would represent a very significant implementation task*”.

The essence of the proposal is that the generators may be able to obtain financially firm access to the regional reference node and /or interconnector price differentials, if they are prepared to pay access fees to TNSPs for this.

Financially firm access, the way the AEMC seems to use the term, means that generators that opt for firm access will receive the reference node price if they are dispatched. If they are not dispatched despite the fact that their bid (adjusted for losses) is below the regional reference price, they will be paid their lost profit (or “margin” as the AEMC has referred to it). This lost profit is the difference between the regional reference price and their bids multiplied by the difference between their actual dispatch and the volume they bid below the regional reference price.

The lost profit paid to generators that opted for firm access (in the event that their dispatch is constrained below the level of their bid) will be funded by those generators that opted for non-firm access and possibly also by the TNSP.

The AEMC’s proposal seems to be at an early stage of development, what might be described as an early “straw-man”. The AEMC makes claims of the many benefits that their proposal will offer but there is no quantitative assessment of the model. The revenue and expenditure flow between generators and between the TNSPs and generators are also not clear.

Some fundamental incentive and design aspect of the proposal also seem unclear. For example:

1. In view of lumpy capacity increments which are typical on high voltage networks, will the “non-firm” generators not simply free-ride off the network augmentation funded by firm generators ?
2. Why will TNSPs invest to expand capacity to the level of the aggregate “firm” access requirement, if non-firm generators bear the financial consequence of network constraints ?

In view of the lack of clarity of the model that the AEMC is proposing, or any detailed description of how it would work, or any quantitative assessment of its costs and benefits, we will reserve our views on this aspect of the AEMC’s proposals.

3. Extensions and Connections

The AEMC has proposed changes to the arrangements for transmission connection and extension. These changes are focused on clarifying the current arrangements and may mean some changes compared to the currently diverse and somewhat opaque arrangements.

3.1. Extensions

We support the AEMC's approach to extensions where connecting parties can build, own and operate extensions and TNSPs have no pre-emptive right to the construction, ownership of operation of such extensions.

3.2. Connections

With respect to connections, the AEMC has proposed that TNSPs will have a monopoly over the provision of connection assets but that they will have more onerous requirements to provide information on costs and services to connecting parties. The AER will also be given the authority to write a guideline on information that TNSPs should provide. Such information provision arrangements are well-intentioned, but the fact remains that the TNSPs will have a monopoly over the development of connection assets.

We therefore do not support the AEMC's proposals on connections. Specifically, it is not clear to us why parties connecting to the shared network should not be able to choose to build and operate, or build and then transfer to the TNSPs, these connection assets. This would replicate the choice that the AEMC has proposed for connection assets. If connecting parties choose not to construct such assets themselves, then they might be developed by the TNSP, subject to the negotiating framework, as the AEMC has proposed.