14 May 2009

Mr John Tamblyn
Chairman
Australian Energy Market Commission
Level 5, 201 Elizabeth Street
Sydney NSW 2000

By email: submissions@aemc.gov.au

Dear John,

Review of Energy Market Frameworks in Light of Climate Change Policies

Grid Australia welcomes the opportunity to make this submission in response to the AEMC's Discussion Paper for the public forum held on 1 May 2009 in relation to its ongoing Review of Energy Market Frameworks in light of Climate Change Policies.

As presented at the public forum, Grid Australia considers that any changes to energy market frameworks should recognise the following guiding principles:

- Market-led developments should be supported to the extent possible;
- Where necessary, arrangements for socialisation of costs should not preclude market-led developments that can proceed without such support (e.g. more efficient renewable generation that is closer to the existing network and capable of paying its stand-alone connection costs);
- Changes to frameworks should complement rather than replace or complicate existing arrangements;
- Incentive based arrangements lead to better outcomes than imposing obligations; and
- Accountability for transmission investment decision making, operation and performance to remain with TNSPs (consistent with governance arrangements adopted by COAG).

The current framework for establishing new generator connections is outside of the framework for the provision of prescribed transmission services. The AEMC has proposed to establish a new framework in the Rules for network extensions for remote generation (NERGs). Grid Australia understands that this is intended to provide a framework for facilitating the establishment of new shared generator connections that are optimally sized, taking prudent account of potential future generation developments in the area.

Grid Australia is broadly supportive of the proposal for a network led approach to implementation of these network extensions. However, access to capital and funding of these investments is a potential issue for some members of Grid Australia, particularly given the AER WACC decision and the current capital constraints facing industry. This issue highlights two important considerations.

Firstly we note that while under the current open access framework for generator connections TNSPs are required to make an offer to connect to the transmission network, there is no obligation to extend the network to the generator's plant to give effect to that connection. Network extensions are negotiated on commercial terms as non-regulated (contestable) transmission services. Given the issues raised above, it is important that any new framework for NERGs not impose an obligation on TNSPs to invest. In other words, TNSPs should continue to be free to make their own commercial investment decisions in relation to network extensions, based on the investment fundamentals for their business.

Secondly, and building on the first consideration, any new framework for NERG investments (that are not part of a NSPs prescribed service obligations) must allow higher than regulated rates of return to encourage the necessary investment to meet climate change policies.

Grid Australia's submission in response to the AEMC's 1st Interim Report highlighted international precedents for this approach. In particular, in the US the FERC has allowed 'adders' to the return on equity for transmission investments that reduce the cost of delivered power by reducing congestion, including grid extensions to connect renewable generation.[1] In December 2008 a 2.5% additional return on equity was allowed by FERC for transmission lines in Oklahoma and Kansas that will transmit wind power.[2]

In making its determination on appropriate incentives, FERC commented that:

> *New transmission is needed to connect new generation sources and to reduce congestion. However, because there is a competitive market for new generation facilities, these new generation resources may be constructed anywhere in the region that is economic with respect to fuel sources or other siting considerations (eg, proximity to wind currents), not simply on a 'local' basis within each utility's service territory. To integrate this new generation into the regional power grid, new regional high voltage transmission facilities will often be necessary and, importantly, no single utility will be 'obligated' to build such facilities. [..] thus, for the Nation to be able to integrate the next generation of resources, we must encourage investors to take the risks associated with constructing large new transmission projects that can integrate new generation and otherwise reduce congestion and increase reliability.*[3]

In addition:

> *Numerous Commentators express general support for the proposal to grant incentive-based [Returns on Equity] to encourage transmission investment stating that it is the most direct and effective means of attracting needed capital to improve the nation's transmission infrastructure.*[4]

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1 These incentives are required as a result of section 219 to the Federal Power Act (amended in 2005), and are set out in FERC Order 679 *Promoting Transmission Investment through Pricing Reform*, Order No. 679-A, 72 Fed. Reg. 1152 (January 10, 2007).

2 http://www.wind-watch.org/news/2008/12/04/us-ferc-approves-incentives-for-transmission-lines/print/

3 FERC Order 679, para (25)

4 FERC Order 679, para (86)

Grid Australia notes that under the current framework for prescribed transmission services TNSPs have the opportunity to earn higher than regulated rates of return by responding to the efficiency incentives built into the framework, and that these opportunities do not exist in the proposed framework for NERG investments. This further underscores the importance of distinguishing NERGs from prescribed services and separating the allowed rates of return for these investments from the regulated WACC, even if the framework established for these investments is designed to be relatively low risk.

We also note two items in this week's Commonwealth Budget that appear to be relevant to the current deliberations:

- the remit of the new body, Renewables Australia, is stated to include the facilitation of investment in transmission networks to connect renewable generation; and
- the 1000 MW of large scale solar generation to which the Commonwealth will make a significant funding contribution is stated to be located "within the national grid".

Finally, Grid Australia notes that the proposed NERG concept requires significant further development at the detailed level where a number of potential implementation issues are already apparent.

We look forward to continued engagement with the Commission and staff on these important matters.

Yours sincerely,

Rainer Korte

Rainer Korte
Chairman
Grid Australia Regulatory Managers Group