



25 January 2012

Mr John Pierce  
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Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

Dear Commissioners,

## **Transmission Frameworks Review – First Interim Report**

### **A: Introduction**

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TRUenergy welcomes the opportunity to provide a response to the Australian Energy Market Commission's (AEMC) Transmission Frameworks Review (TFR) First Interim Report (interim report).

The interim report sets out to: identify and discuss a short list of internally consistent policy packages; explain the framework for the assessment of these packages; and continue testing the materiality of the problems identified in the current transmission framework. It presents five alternative paths for reforming the transmission arrangements to support the delivery of electricity from generation to the customers at the lowest overall cost. In addition, the interim report sets out a number of options for enhancing the planning arrangements and connection arrangements.

The AEMC seeks responses from its key stakeholders to its interim report. Specifically, it requests stakeholder input on its list of policy packages. It does this to help it narrow the options down to one or two preferred options for its Second Interim Report (SIR).

TRUenergy submits its preferred policy positions on the key areas of access, planning and connections in this paper.

## **B: Key recommendations**

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TRUenergy supports the following key proposals in its response to the interim paper.

They include:

### **1. Access**

- Reasonable comfort with the open access regime. Hence, we broadly support Package No:1
- Despite this, we have some concerns regarding the ability of the RIT-T to build out congestion under current arrangements. This can have an adverse impact on generation investment.
- Consequently, we also support further investigating an alternative access model that would allow a generator to mitigate the risk of being constrained off.
- In this regard, we support for further investigation of the access model submitted by International Power's – GDF SUEZ (IPRA) in its preliminary submission to the interim report dated 16 January 2012. However, this does not include support for the congestion management part of their package.

### **2. Planning**

- Potential enhancements to the current planning arrangements
- More significant reform to the planning arrangements, based on a move towards a consistent national model aligned to the current SA regime

### **3. Connections**

- Stronger economic regulation to be applied to connection related services categorised as negotiated services.
- Support for the AEMC's Proposal No: 2 to be applied to connection related services. This would include both interface services and shared network augmentations required by a generator to facilitate a connection.
- Support a market based approach to network extensions.

## C: Key issues

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TRUenergy supports the following positions on the issues of access, planning and connections in response to the release of the interim report.

### 1. Access

TRUenergy is generally satisfied with the open access arrangements in the National Electricity Market (NEM), whereby a generator has the right to connect at any location they choose, is not subsequently charged for use of the transmission network, but does not have any recourse or avenue for financial compensation should congestion prevent its dispatch. Hence, we continue to support open access – package 1. On the whole, we consider that open access has performed efficiently.

However, we do have some concerns that the existing locational signals and RIT-T planning arrangements that are used in conjunction with open access will increasingly fail to build out market related congestion in a timely manner – in particular when only customer reliability based or net market benefit augmentations are undertaken. As the AEMC correctly outlines, the feasibility of the open access model is predicated on the assumption that congestion is built out in a timely manner when it is efficient to do so.

We believe that as we move into a carbon constrained world and the mix of generation in the NEM begins to change, generators will find themselves being constrained off the transmission system more frequently. Hence, the failure of the RIT-T to build out market congestion in a timely manner will become more telling.

For this reason, we consider that it would be prudent for the AEMC to investigate an access model that provides both incumbent and new generators with an option of securing a firmer level of transmission service than is currently available. Such a scheme would provide generators with a clearer mechanism to mitigate the risk of being constrained off.

On this basis, we support further investigation of the access model submitted by International Power's – GDF SUEZ (IPRA) in its preliminary submission to the interim report dated 16 January 2012. IPRA's package includes an access proposal and a congestion management proposal. Importantly, we are indifferent to the congestion management proposal that forms part of IPRA's integrated package.

We are indifferent to IPRA's congestion management proposal (Option 2 – SACP model) because, we do not consider that this model will strengthen investment certainly compared to the current arrangements. The automatic CSC allocation under Option 2 means that existing generators will face broadly the same level of congestion risk as they do now. On this basis, the SACP model does not provide a mechanism to mitigate the long term impact of congestion, and we remain indifferent to it.

Our understanding of the basic characteristics of the IPRA access proposal is that:

- Incumbent generators would have a base level of access which would be established and retained under standard network planning conditions. Therefore, incumbent generators would be provided with an agreed level of access. This could not be degraded by the entry of the future generator.
- A future generator would face a deep connection charge if its entry degraded the access of a current generator. Therefore, the jurisdictional TNSP would be required to maintain this base level of service in the planning domain. Importantly, the deep connection charge would provide a locational signal for the marginal generator to locate efficiently by optimising all project costs including the costs of mitigating impacts on other network users.

- A future generator would have the option to select the level of access it required. It could choose a base level of access to cover all of the output from its generation plant. Alternatively, it might choose a partial level access.
- A generator with a base level of access would be incentivised to limit the amount of capacity that it bid into the market to the amount of its base level access under constrained conditions. This would apply regardless of whether this level of access was grandfathered or purchased under deep connection. Importantly, if it failed to do this, and caused another firm generator to be constrained off, then it would be liable to pay the TNSP compensation for the amount of revenue that the firm generator had to forgo in the market as result of not being dispatched. The TNSP would then forward this amount to the constrained off generator in the form of compensation.
- A generator with a base level of service would be able to trade that service. This would provide the basis for a market in the tradeable access to be developed further in the future, allowing the market to reallocate the capacity more efficiently if that became optimal. This proposal is consistent with a market developing these types of commercial arrangements for prospective users of the transmission system.
- The scheme assumes that all network elements would normally be in service. Additionally, the proposal would apply where the ambient conditions affecting the capability of network elements were at a worst case condition. So, whilst it did not provide protection to those generators that have a base level of service from a critical contingency on the network – it does provide a reasonably firm of base level service – which can provide some comfort to longer term investors that systemic degradation in access to the market will not occur in future (a risk which they currently face, and must factor into their investment decisions). Our understanding is that it would not apply under certain defined circumstances – namely severe ambient conditions, forced or planned outages. TRUenergy supports stronger, market impact linked, incentives on NSP's to address these operational issues, by compensating impacted network users.

Whilst the scheme appears to be similar the proposal developed by the AEMC proposal under Option 4, we consider that there are some differences between the two.

Those differences include:

- Incumbent generators would automatically get a base level of access. This would be established and retained under standard network planning conditions. Hence, incumbent generators would not be required to pay for a transmission charge on their sunk investments. This is efficient because generators have already made their locational decisions – and will not be able to change these if a charge was to be levied. Retirement decisions for the generator are likely to be more efficient under the IPRA proposal, as the tradability of grandfathered rights would allow any benefits of reallocating the access to be captured in the retirement decision. In contrast, is the imposition of a transmission charge on incumbent generators could significantly impact on the financial stability of many generation businesses for negligible changes in efficiency. Following closely on the outcome of the regulator induced impairments related to the Commonwealths Carbon Package, such an outcome would cement investor concerns about the regulatory risk in the NEM, and increase risk premia and consequently the cost of electricity generation in the long run.
- The compensation payable to a firm generator under the AEMC's Option 4 package would be equal to the difference between the Regional Reference Price (RRP) and the relevant Locational Marginal Price (LMP), multiplied by the amount by which the generator is constrained off. If for hypothetical's sake the AEMC decided to implement its Option 2 in conjunction with this Option 4, then the funds used to compensate those generators located behind a constraint under Option 2 could not be simultaneously used to compensate constrained off payments to those generators with firmer form of service under Option 4. As we understand it, the IPRA model does not suffer

from this constraint. Under the IPRA model, compensation would be paid to a constrained off generator at amount that was equal to the money forgone in the market as a result of being constrained off. The IPRA model does not use the same funds as those that are used Under Option 2 to compensate generators for being constrained off. As such, this means that the IPRA model could be implemented in conjunction with Option 2. Whilst we have not supported Option 2, we believe the IPRA access model is superior to the AEMC's Option 4 model because it could be implemented in conjunction with Option 2. As far as we can see, Option 4 could not be applied in conjunction with Option 2.

## **2. Planning**

TRUenergy supports the AEMC progressing its investigation into the following changes to the planning regime in transmission:

### **I. Potential enhancements to the current planning arrangements including:**

- Implementing a national approach for load reliability standards

We consider that national consistency is important in this area, and would support the move towards reliability standards that are independently pre-defined, locationally specific, and risk-based, or economically derived (for example using an industry specific VCR and Energy at Risk), but may be expressed deterministically, as currently apply in SA. This represents an appropriate balance between the potential efficiency of the probabilistic based approach adopted in uniquely in Victoria and the transparency of the deterministic approach used for example in NSW and Qld.

- Improving the consistency of the Annual Planning Reports

We support any endeavours to improve the consistency in which TNSPs' APRs are presented, on the basis this will increase the transparency of the planning process, increase the comparative analysis available to stakeholders and ultimately increase the predictability of the investment planning process.

- Improving the transparency of the RIT-T

Additional transparency in regards to the RIT-T process and documentation will allow market participants to improve their understanding of how TNSPs calculate both the market and competition benefits of an augmentation assessed under the RIT. In addition, it allows generators to better understand non regulated investment options under the RIT-T.

We had previously raised some concerns that TNSPs may not be capturing all of the market benefits of augmentations assessed under the RIT-T. We accept that the RIT-T would capture savings in fuel costs from the dispatch of lower priced generation as a result of that augmentation. However, it fails to capture benefits to market participants from reduced congestion reducing un-hedgable market exposures as a result of that augmentation, which is considered a wealth transfer.

By improving the transparency of the RIT-T, Generators or other non-network service providers will be better informed about the potential and triggers for future augmentations which will increase the efficiency of these non-network investment decisions.

- Aligning revenue resets of TNSPs.

While recognising the step change and process issues required to do so, and the resource intensive nature associated with the AER dealing with multiple TNSP's proposals coincidentally, TRUenergy supports the principle of aligning TNSP regulatory reset periods.

We agree with the AEMC that this process will lead to:

- Greater coordination of all TNSP investment proposals to the AER
  - A more consistent approach to applying economic regulation by the AER
  - An improved ability for the AER to compare, benchmark and align the various TNSPs' capital expenditure, operational expenditure, service target performance incentive schemes, applicable WACC parameters, etc
  - An improved ability for the AER to assess the NEM wide implications of intra-regional investment
- Reliability standards interconnectors

TRUenergy supports the introduction of specific reliability standards for interconnectors.

The requirement to introduce a reliability standard for interconnectors would deliver a certain level of capacity on the interconnectors. As we understand it, the capability of the NEM's interconnectors varies over the long term as system conditions change with load growth, new network augmentations and new generator connections.

Overall, we consider that this will give market participants more transparency and certainly to plan their investment decisions. Whilst we acknowledge that maintaining a level of capacity on the interconnectors could be more costly than implementing other investment options that would meet load reliability standards and /or relieve congestion, on balance, we support this policy as maintaining inter-regional transfer levels promotes wider competition and more informed investment across the supply side of the market.

## II. More significant reform to the planning arrangements. This would include support for:

- Improving the co-ordination of the NTNDP & the APRs

We support the concept of improved coordination of planning documents and for NEM wide inter-regional planning.

However, we can see that it might be difficult for the NTP and TNSPs to endorse each other's national plan and regional plans, respectively.

Therefore, we request for the AEMC consider the idea of requiring both the TNSPs and the NTP to jointly produce a national transmission plan. By requiring these relevant stakeholders to develop the National Transmission Plan together, it is more likely the NTP will be completed in a timely manner without any disputes. In addition, the local knowledge provided by TNSPs to the development of the NTP will benefit for the input of the local knowledge provided by the TNSPs.

- Harmonising intra-regional planning processes and accountabilities

On the balance of evidence, we consider that nationally consistent arrangements such as those based on the current South Australian arrangements would be preferable to the disparate, regionally based approach that exists at present.

Specifically, we consider that under prospective arrangements where a single regionally based 'for profit' monopoly asset owner/TNSP operates under a regulated framework then a more consistent and efficiency focused set of planning arrangements would be established than currently exists, provided:

- they are required to use independently and predefined growth forecasts and economically supported planning criteria, and
- suitable service target based financial incentives are included.

An independent national regulatory body would set the reliability standard - which was determined probabilistically but expressed deterministically - provided it was fundamentally informed through a risk based approach considering an economic indicator such as the Value of Customer Reliability (which may differ from location to location to suit specific local needs) as applied to a customer related measure such as Energy at Risk. The jurisdictional TNSP would be required to augment the transmission system to comply with that reliability standard. Importantly, the local TNSP could then optimise growth related capital expenditure, together with replacement capital expenditure, as well as operational and maintenance related expenditure.

### **3. Connections and extensions**

Given our experience of connecting generators to the NEM, we identified some problems relating to the efficiency and timeliness of the connection process. In addition, we have always felt that there has been an imbalance in the bargaining power when negotiating with a monopoly service provider during the connection process. So, it is important that rule makers recognise and ensure appropriate protection for customers of monopolies (including generators) in regulatory regimes.

It is worth keeping in mind the key requirements of a Generator project developer in establishing a connection regime.

These can be summarised as:

#### **I: Efficient and timely negotiation process**

While it is acknowledged that the connection process needs a degree of flexibility to account for the different phases of a generation projects evolution, it is important that NSP's are able to efficiently process connection negotiations when they are in progress.

#### **II: Delivery of a commissioned connection related asset on time**

Financiers and equity investors require generation projects to be delivered on time to prevent over-runs of construction costs, and the ability to deliver commercial output to the schedule required by the generators customer. Failure to achieve either of these outcomes can have very significant financial implication for the generation project.

Aspects of the generator connection that are not able to be controlled by the developer create risks of these time over-runs. Given that at some point, connection to a regulated network will require agreement with the network monopoly, it is important that regulation requires the monopoly to agree to appropriate terms for construction of connection related assets to ensure that agreed construction schedules and commissioning programs are maintained. Typical commercial terms between arms length parties would involve compensation payments between the parties to ensure the party responsible for delays faces the costs of such delays. It is important that Network business

face strong incentives for timely delivery of their projects in any areas where they control construction.

### **III: Construction of connection related assets on budget**

As outlined above, construction of connection assets on time and on budget is critical to a successful generation development. It is important that strong incentives are in place in construction arrangements to ensure connection related assets are delivered on budget.

Currently, we believe that there is ambiguity and lack of consistency in regards to the definition and regulation of connection related services, which are so important under the open access framework. These issues manifest themselves as direct risks to generation development proposals through time consuming and expensive feasibility, enquiry and application processes, where the specific obligations of the various parties are not clear. In addition one-sided risk allocations in construction arrangements can also be a problem. This can lead to one sided negotiations that are often restricted by the risk adverse policy positions adopted by the TNSP's.

We support the AEMC's stated view that, regardless of whether more significant potential reforms relevant to connection related services are adopted, necessary amendments to the Rules will be required to clarify the rights and obligations of connecting parties and TNSP's. We agree these will be important amendments.

In general, we support the procurement of connection related services in a contestable manner. We believe there are some real benefits to generators from being able to control the construction of a connection asset. Generators who face the risks of construction can take responsibility for managing these risks if they can oversee and control the project costs and timings of connection assets. Additionally, we believe that control of a connection asset lends itself more to contestability and improved commercial outcomes. On the whole, we consider this to be consistent with the NEO.

Nevertheless, in practice we accept that there are some real problems associated with this option. The AEMC has documented some of these concerns in its interim report.<sup>1</sup> However, in terms of meeting the key criteria of providing cost certainty and timing for a generator to procure connection related service, we consider that the market based approach to be reliable. In our experiences to date, we have not been able to achieve cost and timing certainty for the delivery of a connection related service procured through a jurisdictional TNSP providing a regulated service.

Therefore, we would encourage the AEMC to investigate the option of developing a regime that would allow generators to procure connection related services through a market based approach. In Victoria, we are already pursuing this option by exploring with AEMO options to facilitate the development of a Build, Own, and Transfer model for contestable augmentations.

Whilst we encourage the AEMC to investigate developing a more market based approach to procuring connection related services for generators, we acknowledge that at some point all connections will require an interface to the existing regulated network, and hence connection related services provided by regulated monopolies as negotiated services. Given this reality, we support the three high level proposals that have been developed by the AEMC to amend the economic regulation of connection related services.

We believe that stronger economic regulation needs to be applied to connection related services that provide negotiated services. This is necessary because of the imbalance in the bargaining power between TNSPs and generators. The imbalance prevents generators from negotiating efficient and timely outcomes with TNSPs as they have no recourse or alternatives to connecting to the incumbent's assets.

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<sup>1</sup> AEMC Transmission Framework Review – First Interim Report – p.196

We consider that the AEMC's Proposal No: 2 represents an appropriate policy response for amending the approach to regulating connection related services as it aims to establish a package of complementary measures to increase the transparency associated with negotiations.

This would involve specifying that a TNSP must provide:

- mandated breakdown of itemised capital costs (using consistent definitions and categories)
- a transparent view of how operational expenditure charges are arrived at, and the methodology to determine annualised charges, allowing for financing, interest during construction, etc
- reasonable evidence of real costs and any changes in costs
- publicly available standard contract templates that would be set by the AEMC to ensure a balanced and commercially acceptable risk allocation for construction and ongoing operational aspects of the connection
- a standard price schedule and or/a range of estimated connection costs
- the regulated WACC applied to connection assets

TRUenergy believes that that there may be merit in strengthening the negotiated transmission framework even further to stipulate that the single supplier TNSP must abide to a clearer pre-defined response timeframe to ensure the negotiation can be bounded in a way that both parties are subjected to some risk if extended delays are incurred.

In regards to extensions and connection related services that may be defined as separable from the existing shared network, (i.e. Greenfield substations, new lines, etc), TRUenergy appreciates how the AEMC has captured the issues with the existing framework, particularly the matters of:

- If there are barriers in the construction and/or operation of extensions should they be contestable?
- Who should be able to own, operate and control extensions?
- And who would have access rights to the developed extensions?

Nevertheless, TRUenergy supports a market based approach to dealing with network extensions as this increases the incentive for a timely and on budget delivery of a connection related service that occurs as a result of the competitive pressures for innovation and costs reducing measures.

We consider the market based approach to these Greenfield and project specific investments is preferable, where the services are not regulated at all, they may be provided by a generator, a registered TNSP or third party, and there is no third party access permitted. If there are any other barriers to the competitive procurement of extensions, then they should be addressed. TRUenergy considers a competitive approach to dealing with extensions minimises the level of regulatory intervention and increases the incentives through competitive pressures for innovation and costs reducing measures.

**I. A lack of real evidence submitted by the market that market based approach to extensions is not working**

TRUenergy considers that there is strong competition in the construction market for transmission services, and that a workable level of competition in the ownership of extensions exists as long as generators can build and own these assets. For this reason, we cannot see why the current based market approach should be changed.

**II. No compelling reasons why competition in the provision of extensions should be limited to registered or incumbent TNSPs**

TRUenergy cannot find any convincing reason why a third party should not be capable of owning an extension.

We agree that a competitive approach to dealing with extensions minimises the level of regulatory intervention and increases the incentives through competitive pressures for innovation and cost reducing measures.

The interim report argues that in Victoria there are restrictions that prevent entities from holding both a generation license and a transmission license. Furthermore, the AEMC argues that none of the exemptions to this rule appear to cover a situation where an existing generator wishes to engage in the transmission of electricity.

We do not agree that this position is entirely accurate. The cross ownership provisions for generation & transmission were introduced in Victoria in the 1990s. The provisions require that the owners of a licensed Victorian transmission, generation or distribution business cannot have a controlling interest (of at least 20%) of another corresponding business. We suggest that a generator's ownership of an extension would not breach this provision. Therefore, we do not believe it would be difficult for a generator to get an exemption to this rule. Should the AEMC identify any alternate barriers to generator ownership of extensions, we would agree these should be addressed.

Finally, TNSPs are not obligated to provide a network extension under their interpretation of the Rules. Therefore, we are not sure on what basis you could limit the competition of these extensions to incumbent TNSPs, especially if they are not obligated to do them.

**III. Third party rights to access extensions that are paid for by incumbent transmission users**

TRUenergy supports a market based approach to dealing with network extensions.

A competitive approach to dealing with extensions minimises the level of regulatory intervention and increases the incentives through competitive pressures for innovation and cost reducing measures.

Where a party chooses to own and fund an extension, then that market based extension would be considered to be a private asset. Therefore, third party access could not be assumed.

If a third party wanted to get access to a market based extension and could not agree to terms with the owner, then it could seek a 'declaration' under Part IIIA of the Consumer & Competition Act 2010.

If a third party is successful in bringing this action, then it is likely to get access to the extension. Importantly, we agree that chances of a third party getting access to a market based extension will depend on how large that extension will be. We agree with the AEMC that the larger the size of the extension, the more likely it will be that it will satisfy the national significance test.

## E: Conclusion

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TRUenergy has raised a number of issues in response to the AEMC's interim report. These include:

### 1. Access

- Reasonable comfort with the open access regime. Hence, support for Package No:1
- Concern regarding the ability of the RIT-T to build out congestion under current arrangements.
- Support for investigating an alternative access model that would allow a generator to mitigate the risk of being constrained off
- Support for further investigation of the access model submitted by International Power's – GDF SUEZ (IPRA) in its preliminary submission to the interim report dated 16 January 2012. However, this does not include support for the congestion management part of their package.

### 2. Planning

- Potential enhancements to the current planning arrangements
- More significant reform to the planning arrangements focused on increasing transparency and consistency

### 3. Connections

- Stronger economic regulation to be applied to connection related services provided as negotiated services.
- Support for the AEMC's Proposal No: 2 to be applied to connection related services. This would include both interface services and shared network augmentations required by a generator to facilitate a connection.
- Support a market based approach to network extensions.

We thank the AEMC for the opportunity to comment on its interim report.

For any enquiries regarding this submission, please feel free to contact Mr. Con Noutso - Regulatory Manager at TRUenergy on Tel: 03 8628 1240.

Yours truly



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