Vestas

Vestas Australian Wind Technology Pty Ltd

12 October 2012

John Pierce
Chairman
Australian Energy Market AEMC
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By email: aemc@aemc.gov.au

Dear Mr Pierce

Submission re: Transmission Frameworks Review Second Interim Report (EPR0019)

Vestas welcomes the opportunity to make a submission in response to the AEMC's Second Interim Report on the Transmission Frameworks Review (the **Review**).

Vestas is the world's leading supplier of wind power solutions, having installed more than 47,000 wind turbines across the globe. While Vestas is not a market participant in the National Electricity Market (**NEM**), we have been responsible for the supply of more than half of the wind energy capacity in Australia to date.

Vestas is also a member of the Clean Energy Council (**CEC**), and for detailed comments in response to the Second Interim Report we would direct you to the CEC submission.

Introductory comments

Vestas has significant concerns with the Second Interim Report. In particular, we consider that the proposal to introduce an Optional Firm Access regime in the NEM would be a retrograde step. We also consider that such a proposal represents such a significant change to the NEM that it is more properly regarded as a matter of policy (and hence more appropriately determined by members of the Standing Committee on Energy and Resources (**SCER**) rather than the AEMC.

As usual, the context within which the AEMC is conducting the Review is important.

The Australian Parliament has now passed two major reforms to the energy sector while the Review has been taking place; namely the 20% Renewable Energy Target (**20% RET**) and a price on carbon. Both of these reforms are intended to drive significant changes to the generation mix in Australia.

Yet both of these reforms appear to have been ignored by the Second Interim Report and/or will become more expensive for consumers if the Second Interim Report is implemented in its current form.

Optional Firm Access

Vestas considers that the AEMC's Optional Firm Access (**OFA**) model represents a proposal for radical market reform, partly in response to the views of incumbent generators in the NEM that are finding it difficult to remain profitable in the light of the rapid entry of renewable energy generators with low short-run marginal costs.

Vestas considers that the OFA proposal appears to introduce a form of protection through favourable market conditions that benefits incumbent scheduled generators to the detriment of new entrants and existing semi-scheduled (renewable) generators.

We do not consider that the AEMC has demonstrated the extent of the issues which are to be resolved by implementing OFA, despite the significant implementation costs of such a move. No cost-benefit analysis has been provided, nor has the AEMC presented any material costs of the so-called "disorderly bidding" issue that OFA is apparently seeking to resolve.

Without properly quantifying the problem, the AEMC is proposing a radical change that would be disruptive for all market participants and deter future investment in the market.

Concerningly, it appears the AEMC considers the 20% RET to be a distortion to the NEM that needs to be overcome, rather than what it really is: a legislated change to the electricity generation mix, and one that is supported by all political parties in the Australian Parliament.

Tellingly, we cannot see how OFA will provide any benefit to renewable (semi-scheduled) generators. Rather, our analysis of the OFA proposal has found that costs for renewable generators will only increase, and hence the costs to consumers of the 20% RET legislation would increase as a result if OFA was implemented.

Vestas queries what benefits will accrue to consumers under the OFA model. Given the extraordinary increases in the retail electricity prices for consumers in recent years (primarily due to network costs) the AEMC should be especially careful to ensure that any change to access rules does not have a similarly poor outcome for consumers.

The AEMC is proposing that OFA promotes market-led investment in the shared transmission network. However, fundamental NEM design dictates that a profit-driven monopoly controls the NEM's networks. Regulation is applied accordingly. OFA would blur the currently defined boundaries between regulated and market-led investment by proposing that market-led investment take place within the monopoly-controlled area of the market. In our view this fundamentally impedes efficient regulation and contradicts the intent of the National Electricity Objective of efficient investment for the long term interests of consumers.

The OFA model represents a major new entrant risk. It risks the financial viability of future large scale renewable projects due to increased uncertainty about the scale of the increased impact that system constraints will have. For example:

- It is less likely that renewable generators will be investing in firm access, as a greater distance from the regional reference node (i.e. large scale renewable generators are often located on the fringes of the network) would mean higher costs do so.

- Peak demand times are when system constraints become more likely. Renewable generators can make 60-80% of their revenue during the top 20 demand days per year so OFA implies a significant risk for future revenue streams to large scale renewable generators that do not have firm access.

- So-called "contracts for difference" power purchase agreements (**PPA**s) which many generators hold at present would be exposed to a new risk if a renewable 'non-firm' generator is repeatedly subject to a constraint.

- It is possible for future, unforeseeable, network conditions to force a generator to make significant investment in the network to overcome emergent penalties. For example, if another generator procures firm access through a constraint that they are both subject to (note this purchase would be confidential so no warning would be given) the initial generator would be subject to penalties to the firm generator and could then be forced into making a significant investment in firm access to protect its revenue.

- All current contracts would be subject to a 'market disruption' which is likely to be considered a force majeure event. Vestas expects that all current PPAs will require re-negotiation under implementation of OFA.

Again, we are concerned that the AEMC has not considered the above risks, impacts and costs that would be driven by taking the OFA proposal forward.

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The transitional implementation period for OFA is estimated to be 5-7 years, which roughly tracks the same period during which the majority of investment in new renewable energy generation driven by the 20% RET will be in full swing.

As a result, we expect that significant market uncertainty caused by the OFA reform in this period will turn generation investment away, or in the case of 20% RET-driven investments it will make them more expensive and these additional costs will have to be met by consumers without any obvious benefit to defray such costs.

We have not seen any demonstrated evidence that the AEMC's stated objectives to "lead to efficient network investment due to mixed financial incentives on TNSPs" and to "firm contract levels within a region" will be met.

It is fairly clear that incumbent generators will be able to secure a significant benefit from the OFA proposal if it is implemented. However, despite the wording of the National Electricity Objective, it appears that consumers have not been properly considered. Vestas questions how such significant regulatory change could proceed without clear justification or obvious need.

Conclusion

As outlined earlier, the 20% RET legislation unashamedly gives primacy to renewable energy generation, while the carbon pricing legislation also aims to promote low-emissions technologies across the economy.

But the Second Interim Report, if implemented, is likely to frustrate this legislated change in the generation mix and is likely to make such a change more expensive for consumers, both in the short-term and the long-term. And that is an outcome that the National Electricity Objective requires the AEMC to avoid.

Vestas staff would be pleased to meet with AEMC staff to discuss our submission and answer any other questions they may have. Please contact the writer on (03) 8698 7300 to do so.

Yours sincerely,

[signed]

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