



11 December 2014

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce,

Alinta Energy welcomes the opportunity to make a submission in response to the Optional Firm Access (OFA) pricing model presented in the *Supplementary Report: Pricing (the Report)* and appreciates the detailed work in this area undertaken by the Australian Energy Market Commission (AEMC) to date.

Alinta Energy is an active investor in the energy retail, wholesale and generation markets across Australia. Alinta Energy has around 2500 megawatts of generation capacity in Australia (and New Zealand) and a growing retail customer base of over 800,000.

Alinta Energy is currently a member of the OFA industry working group hosted by the AEMC.

Background

Alinta Energy understands the OFA pricing model is intended to:

- Provide access pricing to a market that is able to adapt to changing conditions, particularly demand and generation patterns;
- Introduce more commercial drivers on transmission businesses, and more commercial financing of transmission infrastructure;
- Co-optimize generation and transmission investment by promoting the efficient utilisation of spare network capacity;
- Shift some transmission investment risk away from consumers; and
- Better enable generators to signal where they value transmission capacity.

To this end, establishing an accurate pricing methodology which determines the charges generators will pay under a firm access network access model is essential for ensuring the objectives of OFA can be achieved.

Prototype Long Run Incremental Cost Model

As communicated to participants, the AEMC has developed a Long Run Incremental Cost (LRIC) access model prototype which produces access prices for different levels of access at different locations on the network. The model is based on two network development scenarios:

- A baseline modelled network development scenario, that is, the modelled network development scenario of the transmission network which is in place before a particular access request is received; and

- An adjusted modelled network development scenario, that is, the adjusted modelled network development scenario of the transmission network to accommodate a firm access request made at a specified location, for a specified MW amount of access, for a specified period of time.

Essentially the LRIC which would determine the price paid by generators for network access is the cost difference between these two scenarios.

Alinta's Views

Alinta understands a number of different access pricing models are available in other jurisdictions; however no single superior option has been identified to date which could be applied in the NEM. With this in mind Alinta considers that the proposed LRIC model is the simplest method available for valuing spare capacity and while not perfect it appears to represent the best *available* cost reflective price signalling method for the National Electricity Market (**NEM**). Other pricing methodologies, such as those based on Long Run Marginal Costs and Deep Connection Costs, generally appear to represent “blunter” approaches for charging new entrant firm access compared to that put forward by the AEMC.

Alinta understands that a number of other participants have concerns that the proposed LRIC model may not be relevant for the NEM, citing its known complexities and questioning its applicability given the current operating environment, i.e. low demand and oversupply of generation. Whilst not discounting these views, Alinta understands that if implemented, a complete more comprehensive version of the model would need to be developed, presumably which would go some way to resolving these apprehensions. In any case, any chosen methodology will contain both positive and negative qualities, and whilst the LRIC contains known flaws, on balance it is the best available.

Nonetheless, Alinta is of the view that further development of the model can and should be progressed through the course of the AEMC's work program and has outlined some of the areas for further work below.

Replacement Infrastructure

As noted in the report, augmentation costs are included within the pricing model but network replacement expenditure variables are not, meaning that the model assumes all assets have an infinite life. In the context of a market of declining load growth it may be a fair assessment that the replacement of assets may not necessarily be needed for a significant period of time. Additionally, as noted within the report, if replacement expenditure is modelled, it may significantly contribute to the LRIC price outputs, as currently occurs within TNSP planning reports.

Alinta considers that to completely ignore replacement expenditure may be detrimental to the overall model, especially under a future scenario where load growth actually occurs, in which case replacement costs may significantly contribute to the LRIC access prices and subsequently lead to questions being asked as to why replacement expenditure was not originally considered.

In the interests of model accuracy, Alinta is supportive of the AEMC further investigating and implementing the proposed “stylised asset replacement costs”, whereby expected end of life dates are calculated and may be incorporated if practical as an input into the model.

Forecasting of Flow Growth

An important element of the LRIC model is the forecasting of flow growth on the network. Flow growth has several implications for short and long term pricing as well as the rate of how initial spare capacity is eroded as forecast flows increase due to increasing demand for electricity over time.

The report has outlined the forecast flow growth inputs in the LRIC model are likely to be made consistent with the assumptions made in TNSP's regulatory determinations. That being, medium-term forecasts of flow growth will be based on the Australian Energy Market Operator's National Transmission Network Development Plan. Further, the LRIC model assumes that in the long term peak flow is assumed to grow by a fixed MW amount each year.

However, in the current operating environment of low or negative demand growth and an increasing penetration level of distributed generation which characterises the NEM, the appropriateness of this assumption is not certain. Alinta notes that the final report concluded that "*indicative LRIC prices are not particularly sensitive to assumptions around the long-term flow growth rates*", however it is apparent that LRIC price outputs are somewhat sensitive to assumptions about load growth in the short term.

There may be some merit in the AEMC further assessing revised elements of short term flow growth scenarios which reflects the incremental cost of access provision in a situation where there is zero growth for the foreseeable future. Further testing such scenarios now could potentially prevent in practise, a situation where network augmentation is progressed on the basis of short term load growth forecasts which turn out to be incorrect or where spare network capacity is not valued appropriately.

Other known shortfalls

The report lists a number of other known shortfalls of the LRIC pricing model being investigated by the AEMC, including:

- Non-thermal constraints being un-accounted for;
- Capacity not being provided by replicating lines along the same route;
- Questions being raised as to the quality of data being used within the pricing model;
- If cost inputs which are not realistic are used this could cause the model to produce spurious results which may not reflect actuality;
- Tasmanian prices are not reported as the prototype pricing model is "not producing representative prices for Tasmania".

Alinta is generally supportive of the AEMC continuing to investigate these known shortfalls with a view to addressing any deficiencies in a manner that will not impede the simplicity of the access pricing model. However Alinta would caution against adding any adding levels of complexity to the model wherever possible.

Conclusion

Alinta appreciates the work the AEMC has undertaken to date to develop the prototype LRIC model. While a number of identifiable limitations to the model exist, Alinta is broadly supportive of the AEMC continuing to develop the LRIC model in time for the draft report due out in February 2015.

Going forward, Alinta is of the view that at a conceptual level OFA has the potential to provide a range of benefits as documented in the report. Whether all these benefits can be achieved in practice is uncertain under the current OFA framework. Alinta notes that industry participants have growing concerns about the unknown outcomes which may arise under OFA. As such, it may be worth considering what elements of OFA are well supported by all participants for potential implementation under an abridged version of OFA.

Should you have any queries in relation to this submission please contact Mr Anders Sangkuhl on, (02) 9375 0962.



Yours sincerely,

A handwritten signature in black ink that reads "F. Wiseman".

Fiona Wiseman
Wholesale Regulation Manager