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Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
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Reference: EPR0019

Dear Mr Pierce

A handwritten signature in blue ink, appearing to read 'John', written over the printed name 'John' in the salutation.

Thank you for the opportunity to comment on the Australian Energy Market Commission's *Transmission Frameworks Review – Second Interim Report*.

As indicated in my previous submission to the Transmission Frameworks Review, the development of a framework that provides incentives for generators to locate in uncongested parts of the network is a crucial issue for South Australia. I therefore welcome the Commission's comprehensive work in looking at potential mechanisms to improve the current access frameworks.

South Australia considers that the optional firm access model would significantly improve locational signals for generation, and we therefore continue to support further work on this model. We do consider, however, that the option of deep connection charging should be further considered as we see this as a less complex approach than the proposed Long Run Incremental Costing methodology. It may also offer stronger locational signals to generators.

The Government does not support the Commission's non-firm access model. We maintain that this removes any ability for generators to negotiate firm access and clearly does not address the issues important to South Australia, such as the lack of locational signals and congestion, which are already evident and likely to increase in impact over time.

South Australia is generally supportive of the other aspects of the Commission's proposals, particularly regarding third party access to extensions and reforms that improve coordination and transparency in the national planning process. More comprehensive commentary on the Second Interim Report from my department is attached.

Finally, I note that the Commission states that proposed changes would be complex and represent a very significant implementation task. I consider that it would be a missed opportunity if reforms of this nature were not pursued due to their complex nature. South Australia therefore continues to provide general support to the further analysis of the options proposed in the Second Interim Report.

Should you have any questions in relation to this submission, please contact Ms Rebecca Knights, Director - Energy Markets, Energy Markets and Programs Division on (08) 8266 5500.

Yours sincerely



Hon Tom Koutsantonis MP
Minister for Mineral Resources and Energy

13th October 2012

Attach: submission from the Department for Manufacturing, Innovation, Trade, Resources and Energy



Reference: EPR0019

Department for Manufacturing, Innovation, Trade, Resources and Energy (DMITRE) Submission to the Australian Energy Market Commission's (AEMC) Transmission Frameworks Review – Second Interim Report.

The Energy Markets and Programs Division of DMITRE thank you for the opportunity to comment on the Australian Energy Market Commission's *Transmission Frameworks Review – Second Interim Report*.

As indicated in our previous submissions to the Transmission Frameworks Review the main area of concern for South Australia is the inefficient locational decisions made by generators which result in congestion on the South Australian transmission network. The development of a framework that provides incentives for generators to locate in uncongested parts of the network is a crucial issue for South Australia.

Access Models

South Australia welcomes the Commission's comprehensive work in looking at potential mechanisms to improve the current transmission frameworks. We have previously signalled our support of the optional firm access model as this has the potential to address the issues that have occurred under the current framework.

We do not support the Commission's non-firm access model. Removing clause 5.4A from the National Electricity Rules (NER) would remove any ability for generators to negotiate firm access with a transmission network service provider (TNSP). Clearly this does not address the issues important to South Australia, such as the lack of locational signals and congestion, which are already evident and likely to increase in impact over time.

South Australia considers that under an optional firm access model, locational signals for generation will be significantly improved. This is because generators purchasing access rights will face the costs of investment in the network to meet the required firm access standard, which are likely to be higher in areas where the network is already relatively constrained. Further, non-firm generators will face greater exposure to paying compensation to firm generators if they locate in an already constrained part of the network. This should ensure they locate in optimal parts of the network. The model would also enable generators to secure greater access certainty, thereby improving their ability to contract with retailers and potentially lowering their finance costs. This reduction in financial risk could potentially result in lower generation costs.

We note that the report indicates that the optional firm access model would make fundamental changes to the NEM, and would therefore represent a very significant implementation task.

South Australia agrees with the Commission's view that the reforms required to implement the optional firm access model will be complex. However, we consider there are processes in place to handle these major reforms, and have done so

successfully in the past. It would be disappointing to see reforms of this nature, which have the potential to offer significant benefits to the market, not pursued due to the associated difficulties.

Long Run Incremental Costing methodology

Given the inherent complexity involved in transmission planning, South Australia considers the Long Run Incremental Costing (LRIC) methodology proposed in the report is problematic. South Australia considers the model would require too many judgements to be made on future network outcomes and requirements, and it will be difficult to include all of these aspects, let alone do it with any degree of accuracy, to ensure an appropriate access price is provided to connecting firm generators.

We see the potential for a generator connecting to an uncongested part of the network incurring large access prices due to potential network upgrades being identified in that area, under the LRIC methodology. If these upgrades never occurred, or were over-estimated, this generator would be charged far more than necessary, or could be deterred from locating in this (currently uncongested) part of the network.

South Australia considers that deep connection charging would be more effective in influencing the locational decision of a new generator entrant. A deep connection charge model requires a generator to make an upfront payment that reflects all the costs of connection, including those associated with the shared transmission network. This may result in significant upfront costs in circumstances where a large amount of work would need to be undertaken to the shared network to accommodate the generator and maintain the firm access standard. This, however, is also the primary strength of a deep connection charge regime in that it provides strong locational signals as generators are incentivised to connect to parts of the network that have spare capacity. In addition, under this framework firm access is optional. So a generator can assess whether the benefits of firm access to the transmission network justify the higher initial upfront cost, or alternatively decide to have a lower upfront cost but not have firm access and risk paying compensation to firm generators when a constraint limits access to the network.

Facing the full cost of investing in additional network capacity is likely to present a strong signal against locating in areas where augmentations would be required. Similarly, a signal would exist to connect where (or when) there is spare capacity due to corresponding low charges. This should promote more efficient use of the network and provide a more effective locational signal than the LRIC method.

It has been argued that the imposition of the full cost of a transmission augmentation on a new generator is a first mover disadvantage in that the first user is required to pay for some capacity that it may not require. The first mover's investment would result in spare capacity and this may produce an incentive for potential firm generation to postpone connection and wait for another party to connect and pay for augmentation of the shared network. The framework could seek to address this issue in a number of ways.

Firstly, at the time a generator makes a connection request that contains a firm access component, the TNSP will be required to undertake a planning study to assess what impact the generator's connection request will have on network and the

Firm Access Standard. The TNSP would then release the planning study to inform the market of the upgrades required to accommodate the new request, and any resulting additional capacity available. Other generators, whether it's an incumbent looking to increase its firm capacity or another new generator seeking to connect with firm access, could then negotiate with the TNSP in parallel and contribute to the cost of the required upgrades. This should assist in removing the first mover disadvantage.

In addition, the framework could contain a reimbursement scheme that requires any subsequent connecting generator to refund a proportion of the cost associated with shared network component paid for by the initial connecting generator. Reimbursement would be for costs associated with deep connection assets paid for by the initial generator, and so this would need to be separated from the costs of the connection assets that are solely for the use of the initial generator. Consideration would need to be given as to whether a time limit should apply to the reimbursement scheme.

Finally, a generator would only face the deep connection charge should it decide it is in its best interest to have firm access for at least some proportion of its capacity, otherwise it is free to connect under the current "shallow" connection charges regime.

We encourage the Commission to further consider the option of a deep connection charge methodology being used in the optional firm access model. We believe the deep connection charge methodology provides a less complex approach to charging generators for firm access rights, and is far less subjective due to the cost of the upgrade not including potential future upgrade costs. It would be valuable for a comparison to be prepared in the Commission's modelling of various connections scenarios under both pricing methodologies.

Inter-Regional Access

South Australia supports the Commission's proposed approach to inter-regional access. We believe enabling generators and retailers the opportunity to procure inter-regional access rights on interconnectors provides benefits to the market as it should encourage the market-led development of interconnector expansion. It will also be beneficial for generators who operate in two regions as it provides a mechanism for hedging the price difference between regions.

Firm Access Standard

We also support the introduction of a Firm Access Standard. As we understand it, this arrangement stems from the existing standards for load and obligates TNSPs to plan and expand their networks to maintain these standards to meet the level of firm access required by generators.

The Firm Access Standard will therefore ensure certainty that transmission investment will take place when required to meet firm access requests, as opposed to the current arrangements where transmission capacity is primarily driven by a need to meet reliability standards for load.

South Australia also agrees with the principle that generators access is firm but not fixed, and so the Firm Access Standard would be scaled back under certain operating conditions.

Planning

South Australia is supportive of reforms that improve coordination and transparency in the national planning process, in particular inter-regional planning, and allow opportunities to be identified for a more coordinated approach. We continue to support an incentive based regulatory and planning regime for transmission networks that incorporates economically derived reliability standards that are deterministically expressed.

South Australia supports the expanded role of AEMO as the National Transmission Planner including formalising its role in reviewing TNSPs' draft APRs and RIT-Ts, as well as producing a standard set of regional demand forecasts and providing these to the TNSPs. These roles are currently provided by AEMO in South Australia and we see benefit in this continuing. Transferring the Last Resort Planning Power from the AEMC to AEMO also seems appropriate given the knowledge base of AEMO.

South Australia is also supportive of the proposed enhanced role of the TNSPs, particularly with regard to promoting consultation between TNSPs in order to identify network investment options which cross regional borders.

As discussed in our submission to the First Interim Report, South Australia supports the enhanced coordination of the NTNDP and TNSP's APRs, as this would facilitate improved planning of National Transmission Flow Paths. However, South Australia considered that the requirement for bilateral endorsement could potentially result in significant delays in the release of the NTNDP and a TNSP's APR in the event that agreement could not be reached. We now support the framework proposed in the Second Interim Report which does not impose the sign-off requirement but maintains and formalises greater coordination and discussion between TNSPs and the NTP.

Connections

South Australia supports the Commission's proposed improvements to the negotiated services regime for connections to the transmission network.

We support enhancements which improve transparency associated with the connections process and help to alleviate any information asymmetries that currently exist. We consider it is important to ensure that as much information as possible is provided by TNSPs that would allow greater ability for the connecting parties to forecast potential costs early in the process. It is equally important that TNSPs charges are cost-reflective and that the process that leads to the formulation of these charges are transparent. The proposed amendments that require TNSPs to publish more information, such as design standards, and disclose more cost information to connecting parties should assist in this area.

While we see some merit in the proposal to increase the role of connecting parties in the process of tendering for connections, we also note that implementing these changes may increase the time and cost of connections for these parties. Requiring

the TNSP to provide information to the connecting parties and take the connecting parties views into account when making a tender decision is a beneficial change given that the TNSPs decision will impact on the connecting party. However, the final decision on which tender applicant is selected has to remain with the TNSP as they will bear the risk of this decision due to their responsibility for the shared network. We therefore see the role of the connecting parties as being limited to being a consulted party, with the final decision remaining with the TNSP. They should not be required to select the tender applicant preferred by the connecting party (however would be free to justify why or why not they chose the relevant tender applicant), nor face dispute resolution proceedings if the connecting party is not satisfied with the TNSPs choice or reasoning for the choice. We believe a balance needs to be found between being overly prescriptive, resulting in greater time and costs of connection processes, and providing connecting parties with a greater involvement in the tender process.

As stated in our previous submissions, with patterns of generation investment changing, and generators locating further from the existing shared network and around common locations, South Australia supports allowing third party access to network extensions. Further extensions of the network to connect generators may not be efficient if existing extension lines are already present in specific areas. We therefore consider that relevant amendments should be made to confirm that third party access to extensions is allowed.

South Australia supports the Commission's proposal to allow connecting parties a choice when establishing an extension. We believe the connecting party should be able to make use of any competition that exists in certain elements of the supply chain by issuing competitive tenders for those elements. The connecting party should also be able to request the TNSP to provide the end-to-end service as a negotiated service, and the TNSP should be required to do so. We also agree that in these situations the TNSP should be bound by the transparency provisions of the negotiating framework. Requiring the TNSP to provide tender information, as is being considered for connections, should not be supported as the connecting party should already have the option of running a competitive tender for the provision of the extension. The Commission's proposed approach is therefore supported.

We are also supportive of the proposal which requires a connecting party, or third party, to register as a TNSP when it owns an extension, or be required to gain an exemption from the AER for this requirement. The exemption may include a requirement to allow third party access to the extension.

We agree that the NER should specify that, if a third party connects to a TNSP owned extension, then the transmission line should be upgraded to ensure it continues to operate at unconstrained levels, thereby ensuring that the existing customers or generators are not disadvantaged. The cost of this upgrade should be borne by the third party causing this upgrade. The NER could provide greater clarity regarding the rights of incumbent generators in these situations in a variety of ways. Firstly, in respect of any capital contributions they have made towards the cost of the extension, a reimbursement scheme could be introduced so that any third party connecting to the extension is required to repay a proportion of the costs to the incumbent generator. Careful consideration would be needed to ensure the costs are allocated appropriately to the third party as it may already be required to pay for the upgrade costs required to ensure the unconstrained operation of the extension.

Reimbursement would be limited to contributing to any costs the initial connecting party paid for the extension, in addition to the upgrade costs. Secondly, if the extension is not upgraded to sufficient levels, the existing generator may face greater constraints following the connection of the new generator to the extension. If this is the case, we believe the incumbent should be able to receive some form of compensation if third party access is allowed. We therefore believe a form of reimbursement or compensation scheme is required to ensure the initial generator is not deterred from building an extension, in situations where economies of scale exist in expanding the network.

Finally, we support amendments that clarify what each transmission service required to connect to the network involves, and these provisions should include the clear boundaries of what is considered a shared transmission service, a connections service and an extensions service. TNSPs obligations regarding connections and the provision of services should be clear and whether the construction of the underlying asset is included in the provision of a service should be unambiguous. This will be an area of increasing concern as new and remote generation increases on the transmission system in response to both demand and climate change policies. This is of particular concern to South Australia with geothermal and wind generation opportunities in remote areas.

Should you have any questions in relation to this submission, please contact Rebecca Knights, Director, Energy Markets, Energy Markets and Programs Division on (08) 8266 5500.

Yours Sincerely



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EXECUTIVE DIRECTOR,
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27/9/2012