

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

Reference: EPR0019

Dear Mr Pierce

TRANSMISSION FRAMEWORKS REVIEW: SECOND INTERIM REPORT

Macquarie Generation welcomes the opportunity to comment on the AEMC's *Transmission Frameworks Review, Second Interim Report*, released publicly on 15 August 2012.

The key area of interest for Macquarie Generation in this review is the discussion and analysis of options for managing generator access to the transmission system. The AEMC has outlined two approaches for coordinating and pricing access: the status quo with the removal of any reference to constrained-off compensation for generators (clause 5.4A) and the Optional Firm Access model (OFA).

Macquarie Generation has argued consistently over a period of years that the existing open-access transmission model has functioned effectively and efficiently. We base this view on the following observations, supported by data and analysis in our earlier submissions:

- There is no evidence that generation investment in the NEM has not kept pace with load growth, or that this is likely to change going forward;
- There is little or no evidence to suggest that the existing framework is encouraging systematically poor locational, operational or investment outcomes;
- AER and AEMO data both show that congestion costs have been extremely low through time as a proportion of NEM turnover, less than 0.1%, and those costs have fallen significantly in recent years;
- TNSPs have managed to build out those relatively few points of material intra-regional congestion within a year or two of constraints occurring;

- The existing open access arrangement provides investors with strong incentives to locate a power station in a generally unconstrained part of the network. A potential new generator would consider:
 - The existence of suitable sites as regards key inputs, such as fuel, environmental approvals, transmission infrastructure and water;
 - The general incidence of network constraints in the vicinity of particular sites;
 - Load flow analyses to assess marginal loss factors and possible constraints;
 - TNSPs/AEMOs relevant forecasts, planning and investment programmes.
- The RIT-T is designed to ensure reliability in the bulk supply system is maintained and to facilitate transmission investment when it is economic to do so. There is no evidence of any failing in the RIT-T assessment framework or the application of the test;
- The NEM regional structure and dispatch process has facilitated a deep and healthy derivatives contract market facilitating efficient risk management in the NEM.

Macquarie Generation is not aware of any persistent or material congestion problem within the NEM that would give rise to the need for a substantial overhaul of existing dispatch and access arrangements. Past work to quantify productive efficiency losses from disorderly bidding show only very minor costs. We note that TNSPs have invested heavily in transmission systems in recent years. At the same time aggregate and peak demands across all NEM regions have flattened or fallen. AEMO forecasts do not show any substantial recovery in demand levels in the next few years and Macquarie Generation anticipates a slow recovery in demand over the longer term. There is no reason to doubt that the current TNSP planning and RIT-T processes are not capable of delivering timely new transmission investment.

Macquarie Generation appreciates the AEMC's efforts in developing and explaining the detail of the OFA model. Much good thinking has gone into designing an access rationing mechanism that could potentially fit within existing NEM institutional and operational structures. At an abstract level, the OFA model has a number of features that would appear at face value capable of ensuring that generators do not bid below efficient costs and addressing some of the inevitable problems of coordinating market-led investment in generation plant and monopoly regulated transmission investment. But there is a big difference between a concept and practical application.

Macquarie Generation has participated in the preparation of the detailed submission prepared by the National Generators Forum to the Second Interim Report. That submission and the accompanying analysis prepared by Frontier Economics raises a number of questions and concerns about how effective the OFA could be in addressing perceived problems as well identifying a range of potential operational issues. The submission concludes that:

- The OFA model would result in a profound centralisation of decision making over the planning of an investment in new generation and transmission infrastructure compared to the present arrangements. Rather than being a ‘market-led’ approach to development of the transmission network, it puts more faith in the views of TNSPs than does the current regime. This represents a clear and unavoidable drawback of the proposal;
- The OFA proposal gives rise to numerous governance and implementation issues. These issues arise from the setting of firm access standards, access pricing, rights trading, the role of the RIT-T and queuing policy. Minimising the harm from these issues is likely to require the close involvement and attention of the AER. However, not only would this place enormous demands on the regulator, it would be likely to slow the process of conferring and managing firm transmission rights;
- The proposal does not offer demonstrable benefits over the status quo arrangements even in the areas it directly aims to resolve. In particular, it fails to ensure firm access to support contracting and it maintains incentives for non-cost reflective bidding and inefficient dispatch outcomes.

The OFA model would involve a degree of complexity and cost that far exceeds current arrangements. A generation business would require systems and resources to understand the impact of all constraints types affecting each and every flowgate and how those constraints impact on any firm access rights and the firm and non-firm rights of all other generators. The OFA model also greatly extends the responsibilities and functions of TNSPs and the AER. Complexity arises in a number of ways:

- Setting normal operating conditions and the firm access standard for each and every flowgate in the NEM;
- Setting accurate firm access standard scaling factors under each normal operating and abnormal operating condition;
- Determining baseline transmission expansion plans for every flowgate;
- Applying the RIT-T under a range of scenarios incorporating applications for firm access in different parts of the network which may or not be required to meet reliability standards;
- Deriving accurate access prices and payment profiles over multi-year periods.

The Second Interim Report notes that the OFA model would result in significant implementation and transitional costs and that there are “risks associated with moving away from a regime that has delivered transmission and generation investment to date, to an untested regime that is fundamentally different, and which risks creating unintended consequences”. Our concern is that while the AEMC states that the OFA would need to result in materially efficient outcomes to justify the costs associated with moving away from current arrangements, to date no credible evidence or analysis has been put forward by the AEMC or industry stakeholders to justify such changes.

Implementing the OFA model will require major changes and amendments to the NEM Rules. At some point in the process, the AEMC will need to demonstrate that there are efficiency benefits that outweigh the implementation and transitional costs for the NEM institutions and market participants. Macquarie Generation considers that should the AEMC recommend in favour of the OFA in the Final TFR Report, it should at the same time provide sufficient supporting analysis to demonstrate net benefits consistent with the National Electricity Objective, which could then be incorporated in any subsequent Rule change process.

Yours sincerely



LEISL BAUMGARTNER
GENERAL MANAGER, CORPORATE AFFAIRS

17 October 2012