Department of Infrastructure, Energy and Resources

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Australian Energy Market Commission
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Re: National Electricity Amendment (Scale Efficient Network Extensions) Rule 2010

The Office of Energy Planning and Conservation, of the Department of Infrastructure, Energy and Resources, welcomes the opportunity to provide comment on the consultation paper of the *National Electricity Amendment (Scale Efficient Network Extensions) Rule 2010.*

The Tasmanian Government is still not fully formed following the State Election on the 20th March 2010. Due to this fact we must stress that this submission is the view of the Office of Energy, Planning and Conservation and not those of the Minister or Government.

Please contact Tim Astley on (03) 6233 3091 if you have any questions in relation to the matters raised in our submission.

Yours sincerely

Tony van de Vusse
DIRECTOR

21 April 2010

Rule Change Request – Scale Efficient Network Extensions

As noted in the Consultation paper, the current Rules and market framework seem to ignore some risk of inefficiencies when it comes to multiple generators in the same locale some distance from the current network wishing to connect in a short time frame. This is a scenario that will be more likely to arise with the need to increase the level of renewable energy generation in Australia as a response to climate change.

As such we agree that there is a need to review the current Rules and possibly even the market framework to ensure the most economically efficient generation is built and connected to the network in the most cost effective manner.

We believe that the most efficient outcomes are likely to occur when incentives and risks are aligned. We are concerned that the proposed Rule change does not seem to achieve this alignment as well as possible.

The premise behind this rule change is that multiple generation proposals may come forward in a similar location, currently distant from the transmission network. The current situation is that each proponent will be required to fund the connection to the network, potentially giving rise to duplication of effort and inefficient outcomes. While we agree with that this is a risk, the question arises as to how often this will actually occur. There are many proposed generation projects which never get beyond the conceptual stage. Thus, the success of the SENE proposal depends on the ability of AEMO and TNSPs to accurately predict the size and timing of future generation projects. As indicated in the consultation paper there is a significant risk this will not occur as envisioned. This, when coupled with the incentives on the NSPs to over-size SENEs due to the guaranteed return on investment, means there is a significant risk that SENEs may not be efficiently sized under the proposed model.

Are the risks associated with oversizing transmission assets outweighed by the potential efficiency gains from efficiently sized network extensions? This will depend on the accuracy of the forecasting and how the incentives for various parties are aligned. Given the proposed model, where the risk is borne by customers who have no control on whether the generation forecast to be constructed actually is constructed, it would seem quite likely that the risk of overbuilding transmission assets could be significant.

While the proposed Rule change contains some checks and balances we are not convinced they are sufficient to protect end customers. For example, it is not obvious that AEMO should be any better than the TNSP at forecasting the likelihood of future generation projects being completed. It is also unclear on what grounds the AER would disallow a proposed SENE. Regulators are traditionally risk averse and would usually wish to avoid being portrayed as causing future investment inefficiencies and are therefore unlikely to disallow a SENE once put forward.

We believe alternative approaches need considering. As stated in the consultation paper the “regulatory principle [is] that risk should be allocated to those that are best placed to manage it”. The consultation paper seems to imply that since customers are the primary beneficiaries then they should bear the risk. However, it is unclear that customers are the primary beneficiaries or that they are best placed to manage the risks. Other beneficiaries include the national interest from increased energy security and increased economic development, generators who get cheaper connection to the network and less constraints in dispatch and TNSPs who get increased returns on investment whether the SENE is successful or not. We assert that those most capable of ensuring the success of a SENE, generators, are not bearing any of the risk under the current scheme design.

We believe the allocation of risks should have regard to three factors: who can bear the risks, who can do something about them and who benefits from risks successfully managed. In our opinion these considerations point to the proponents of new generation.

Further, the best method by which to measure the suitability of the proposed model is to compare the outcome it would produce against that achieved by an omniscient central planner. Given full information on the efficiency of various potential generation options, an omniscient central planner would be able to rank future generation projects. This could then be coupled with the necessary connection investment required and the most efficient network investment calculated. Once a generation project was ranked near the top of the list it would be constructed, thus ensuring the network investment was efficient. Under the proposed Rule Change there is no guarantee that a generation project presumed by AEMO and the TNSP as likely to be constructed will actually occur and thus no guarantee that the network investment will be utilised.

Another point of concern is the lack of jurisdictional involvement in determining the location of a SENE. Returning to the omniscient central planner, not only would the planner be interested in the most efficient delivery of electricity, they would also take into consideration the delivery of other services and any additional infrastructure requirements in the area that would arise from the construction of the electricity assets. For example, the construction of a number of power stations should see at least a short term increase in population in the area which could result in additional educational and health services being required from the Government. The requirement for road improvements, funded by local and state governments, may also arise. It may well be that a State Government has a regional development policy that would make locating a SENE in the same area more economically efficient than locating it elsewhere.

We are also concerned that the current proposal does not seem to require one SENE to be 'built out' prior to the commencement of further SENEs. There is a strong argument for encouraging generation to locate where a SENE has already been constructed rather than start a second SENE and thereby increasing the risk of over investment.

We believe more work is required before the Rule Change in made. We are concerned that the current proposal may be too limited by the boundaries of the current Rules framework. It is our belief that the reference frame for this work needs to be widened to allow alternative approaches to managing the risks to be explored. For example, one possibility might be to encourage entrepreneurial investment from either the generators, TNSPs or a third party.

This is a traditionally difficult area for infrastructure generally and we appreciate the work that has gone into it so far. It is a worthy enterprise and one which is worth getting right.