

13 May 2011

John Pierce  
Chairman  
Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

Dear John,

### **Re: Strategic Priorities for Energy Market Development**

SP AusNet welcomes the opportunity to make this submission in response to the AEMC's Discussion Paper on the strategic priorities for energy market development. SP AusNet is a member of the Energy Networks Association and Grid Australia and we support the submissions made by those organisations.

From SP AusNet's perspective, the strategic priorities identified by the Discussion Paper are the right ones for the AEMC to focus on. In particular, SP AusNet supports the following description of the strategic priorities provided in the Chairman's opening message:

*"Our first priority recognises the need for unprecedented investment in generation capacity over the next decade to maintain reliability and security of supply, to meet rising peak demand, to respond efficiently to government climate change policies and enhance competition.*

*Our second priority focuses on the need to facilitate the expansion of cost effective consumer choices and improve energy efficiency.*

*Our third priority complements our focus on generation investment by helping to ensure that the arrangements for investment decisions, funding and pricing for the use of the transmission network are well thought through and will contribute to our objective to help minimise the overall costs of transmission and generation."*

The Discussion Paper indicates that, in light of submissions received, the AEMC will publish details of the work programme to deliver each priority. From SP AusNet's perspective, it is the scope of that work programme that will determine the overall success of the AEMC's strategic review. With this view in mind, the remainder of this submission highlights those matters that SP AusNet considers should be the focus of the AEMC's work programme. In addition, SP AusNet has also identified some matters that it considers should be given substantially less attention than currently contemplated in the Discussion Paper.

## **A predictable regulatory and market environment for rewarding economically efficient investment**

SP AusNet concurs with the AEMC's observation that the required generation investment over the next five years, which is estimated to be up to \$1.5 billion per year, depends on a stable regulatory and commercial environment. Unfortunately, the policy uncertainty regarding the pricing of carbon emissions is likely to adversely affect generation investment. SP AusNet also agrees with the AEMC that uncertainty regarding possible future changes in Government policy on carbon pricing will continue to create risks for generation investment, resulting in lower levels of investment in generation capacity.

The AEMC is also correct to highlight the likely impact of increased investment in renewable energy. In particular, the connection of larger amounts of intermittent generation will provide challenges to network companies and AEMO as system operator. In particular, the networks will need to be even more responsive to connection enquiries and ensure that projects are scoped efficiently to facilitate new investment. In this regard, the AEMC's recent work in relation to Scale Efficient Network Extensions is a welcome development.

SP AusNet concurs with the view that the AEMC should continue to monitor market developments to help ensure that the wider environment for investment is as predictable as possible. The AEMC's role in this regard is particularly important given:

- the substantial investment required in generation capacity;
- the unprecedented growth in renewable generation;
- the uncertainty surrounding carbon pricing; and
- investors' lower appetite for risk following the global financial crisis.

While SP AusNet fully supports the AEMC's initiatives to monitor and advise the MCE on these matters, it is a concern that the AEMC appears to be comparatively sanguine in relation to the environment for network investment. In particular, page 7 of the Discussion Paper makes the following comment:

*"The impact of policy uncertainty on investment decisions will be greater in the competitive generation and retail sectors than in the monopoly network sectors."*

SP AusNet notes that prospective investment in network assets depends on the same capital markets and risk/reward considerations that apply to investment in generation capacity. A change in the regulatory environment for network businesses may drive investment away from network infrastructure if investors perceive the risk/reward balance to have moved adversely. As noted by the AEMC in relation to generation investment, there is a need for a stable regulatory and policy environment if investment in long-lived assets is to be promoted. The same requirements for regulatory and policy stability apply equally to long-lived network investment.

The AEMC is correct to highlight the important role of networks in facilitating investment in generation capacity, particularly renewable generation. In this regard, it is essential,

therefore, that the AEMC also seeks to encourage a stable regulatory environment for networks.

### **Building the capability and capturing the value of flexible demand**

SP AusNet agrees with the AEMC's strategic focus on 'building the capability to capture the value of flexible demand'. While demand-side response has always played an important role in energy markets, the potential benefit from demand-side participation has never been greater. There are two principal factors that are driving change in this area:

- technological advances provide the information flows and load management tools for customers to participate in the market and for networks to interface with a more responsive demand-side; and
- the transition to a lower carbon economy creates greater opportunities and incentives for demand-side participation.

It is the combination of technological advances and the transition to a lower carbon economy which is creating the potential for radical changes in electricity usage and storage. A corollary of the growth in intermittent renewable generation is that a flexible demand-side is valued more highly. Opportunities will arise to capture the value from a less predictable supply side, perhaps through enhanced storage capability or indirectly through greater use of electric vehicles. More broadly, these market developments raise a number of important practical and regulatory issues, including the following questions noted in the Discussion Paper<sup>1</sup>:

- What should regulated networks be obliged to do in respect of investment in, and providing access to, smart grid technology – and how should economic regulation be designed to provide the right incentives?
- What is the boundary between regulated and competitive activities, and how should access and pricing be regulated across this boundary to promote competition and enable innovation and flexibility whilst providing appropriate customer protection?
- Should network businesses (or affiliate businesses) be able to sell load reduction contracts in the wholesale market?

SP AusNet agrees with the AEMC's observation that it is important to establish the right market conditions to facilitate cost effective demand-side participation and the offering of energy services products<sup>2</sup>. This observation is consistent with SP AusNet's view that innovation depends on establishing appropriate commercial incentives. While regulated outcomes have a role to play, the primary focus should be on competitive market solutions and the prospect of investors achieving commercial rates of return.

SP AusNet is particularly conscious of the potential changes to its role as a distributor, and the new investment that will be required to facilitate and manage increasingly diverse energy flows across the network. A particular area of interest is the increasing role that

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<sup>1</sup> AEMC, Discussion Paper, page 43.

<sup>2</sup> AEMC, Discussion Paper, page 44.

Distributed Energy Resources (DER) will play in meeting peak demand. SP AusNet will have to adapt its operations to manage greater complexity and the impact of greater distributed energy on the network. For example, as more distributed generation emerges, there will be technical factors that impose network costs, such as network upgrades to address fault levels. The recovery of those costs is an emerging issue, and it has the potential to act as a brake on DER, if such costs are recovered solely from DER proponents.

Given the potentially rapid changes in this area, SP AusNet particularly welcomes the AEMC's focus on these issues in its strategic review.

### **Ensuring the transmission framework delivers efficient and timely investment**

SP AusNet agrees with the AEMC that the ability of the transmission network to connect substantial new generation, potentially in locations remote from the existing network, in a timely and cost effective way, will be crucial to meeting the Federal Government's environmental targets at reasonable cost. In addition, the transmission network must remain robust and resilient to major changes in the mix of generation, including the expected substantial increase in intermittent generation. The AEMC is correct in its view that these changes will present new challenges for TNSPs in operating and designing networks, and will necessarily drive new investment requirements.

SP AusNet notes that the AEMC's Transmission Frameworks Review is examining a number of issues that are highly relevant to the AEMC's strategic priority to ensure the delivery of efficient and timely investment in transmission. In particular, the Transmission Frameworks Review is examining: the nature of access; network charging; congestion; planning; and connection. SP AusNet has submitted its views on these issues through the AEMC's consultation process, and we regard the Transmission Frameworks Review as being appropriately scoped to address the AEMC's third strategic priority.

We note that since the release of the AEMC's Discussion Paper, IPART has recommended a review of network regulation. We would consider this premature given the AER's stated intention to lodge a package of rule changes with the Commission on the completion of its internal review of the first round of price reviews under the existing framework.

Chapter 6A of the Rules was settled in November 2006 following an extensive review by the AEMC. In SP AusNet's view, Chapter 6A incorporates key elements of current 'best practice' economic regulation for electricity transmission in Australia and considers that changes to Chapter 6A should be addressed through the AEMC's Rule change process.

The discipline of the AEMC's Rule change process is the appropriate vehicle for addressing the concerns that have recently been raised by commentators, such as Professor Garnaut, which SP AusNet regards as unfounded. The national electricity objective of promoting efficient investment for the long term interests of consumers of electricity depends on a stable regulatory environment. Therefore, SP AusNet does not support a widening of the scope of the Transmission Frameworks Review.

SP AusNet welcomes the opportunity to make this submission to the AEMC, and we would be pleased to discuss this submission in further detail with you at your convenience.

Yours sincerely,

A handwritten signature in blue ink, appearing to be 'AP', with a long horizontal line extending to the right.

Alistair Parker  
Director Regulation and Network Strategy