grid australia
BACKBONE OF THE NEM

13 May 2011

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

Dear John,

Strategic Priorities for Energy Market Development Discussion Paper

Grid Australia welcomes the opportunity to make a submission in response to the Commission's Strategic Priorities for Energy Market Development Discussion Paper (the Paper) published on 1 April 2011.

Subject to the comments below, Grid Australia considers that the strategic priorities identified by the Commission are generally appropriate. However, Grid Australia does not consider that the third strategic priority should include the efficiency of the transmission economic regulatory framework, given the expectation of an impending Australian Energy Regulator (AER) Rule change proposal on the subject.

A predictable regulatory and market environment for rewarding economically efficient investment

In regard to this priority, Grid Australia submits that the Commission's focus should be on the policy mechanisms needed to secure future adequate levels of generation investment, particularly in relation to base load power. Broadly, the situation in the past where there has been an overhang of generation capacity in Australia has steadily evolved to a tighter balance between supply and demand. However, generation assets are ageing and the current investment environment tentatively emerging from the global financial crisis remains fragile. In particular, it appears significantly affected by uncertainty regarding how best to respond to the challenge posed by climate change.

In addition, there are signs that energy input costs will rise in the medium-term with capital costs likely to respond to the expected increase in world energy demand and fuel costs being influenced by Australia moving to a global gas price. Grid Australia notes the Commission has not nominated a strategic priority in relation to the development of the gas market. However, given these risks, there may be a case for reviewing whether there are ways to improve the competitiveness of gas supply[1].

Taken together, these provide clear signals that the frameworks for ensuring efficient investment in electricity generation capacity should be an important priority. They also raise the related question whether the ways in which energy prices are signalled to customers are as effective as they should be in order to support an appropriate generation mix.

By comparison, the evidence is that the transmission planning and investment framework continues to work well. That framework is the result of a long and careful process of COAG-led industry reform, combining a stable regime with the opportunities for incremental improvement. It ensures that investment is efficient and timely, appropriately takes into account both national and local dimensions and, with the recently enhanced Regulatory Investment Test for Transmission (RIT-T), strikes a pragmatic balance regarding the breadth of the analysis and level of information sharing and consultation required to support specific investments. Recent criticisms of the planning and investment framework by the Garnaut Update Paper No. 8 are misguided and are addressed in the attached copy of Grid Australia's response to that publication.

Finally, there are also processes within the planning framework for ensuring that network service levels are aligned with the expectations of energy consumers. Grid Australia supports the operation of those processes including efforts to make them more transparent.

Building the capacity and capturing the value of demand flexibility

Grid Australia continues to support improvements in the ability of energy users to participate meaningfully in the market. That challenge is complex and part of the solution is to provide network businesses with greater scope to develop innovative solutions that support customer participation. Some of these opportunities were discussed by the Commission in its Review of National Framework for Electricity Distribution Network Planning and Expansion as well as the current Demand Side Participation Review. While much of the value from this sort of innovation will lie within the distribution network sphere, Grid Australia notes that there may be opportunities arising from that work for transmission network service providers to enhance demand side effectiveness.

Ensuring the transmission framework delivers efficient and timely investment

Grid Australia agrees with the view expressed by the Commission in its recent Transmission Frameworks Review (TFR) Directions Paper that it is timely to review a number of aspects of the transmission framework that have implications for the competitiveness of the generation sector (generator access, transmission charging, improving congestion management, supply standards and connection arrangements). In regard to the last of these, Grid Australia is already working with other key stakeholders to examine where there may be scope to improve the processes needed to connect transmission customers.

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[1] This will also be relevant in terms of the Commission's input into the Commonwealth Government's development of its energy White Paper.

Grid Australia also notes the commentary in the media regarding recent rises in retail electricity prices. Amongst other things this commentary includes calls to re-examine the economic regulatory regime applicable to both transmission and distribution network businesses.

Grid Australia is concerned that these calls have been made without a full understanding of that framework. There are legitimate reasons why electricity network prices are currently increasing at rates well in excess of general price movements. These include:

- as per generation, the 'overhang' in network capacity from earlier years has been 'used up' and investment in new capacity is required to meet growth in peak demand;

- a move towards 'more conservative' planning standards — notably, recent changes to distribution standards in New South Wales followed a 2004 review[2] of those standards applying in Queensland due to stormy periods in the south-eastern part of that State;

- a 'bow wave' of asset replacement investment is required over the next few years — most network businesses undertook substantial investment in the 1960s and 70s and the assets created during this period are now coming to the end of their economic life;

- the growth in maximum demand has exceeded the growth in energy usage in recent years due to a range of factors, including the increased use of air conditioners — a significant proportion of network investment is required to meet very short periods of peak demand and this capacity is not utilised for most of the time; and

- increases in regulated revenues and, hence, prices reflect real increases in the cost of capital associated with the global financial crisis. The risk adjusted cost of debt increased to record highs during this crisis and remains high in historical terms.

These reasons have been widely acknowledged[3]. In particular, they have been explicitly affirmed by the Chairman of the Australian Energy Regulator (AER) in a letter to the Australian Financial Review this week[4].

Grid Australia understands that the AER is currently reviewing its experience of the economic regulatory framework for network businesses, based on the revenue determinations it has conducted since the implementation of chapter 6 and chapter 6A of the National Electricity Rules. Subsequent to that review, the AER may propose a number of possible improvements or enhancements to the framework via a Rule change to the Commission later this year.

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2 Report on Electricity Distribution and Service Delivery for the 21st Century prepared for the Queensland Government in 2004. The Government's response was published in August 2004 and expressly required the adoption of 'more conservative planning standards'.

3 See, for example, recent transmission revenue determinations by the AER, the Parry-Duffy NSW Electricity Network and Prices Inquiry (Final Report, December 2010) and IPART's Changes in Regulated Retail Electricity Prices from 1 July 2011 (Draft Report, April 2011). For further material regarding claims made by IPART in that draft report, see the attached Energy Networks Association submission.

4 We understand that the Commission has received a copy of this letter dated 11 May 2011.

Grid Australia notes that the Commission, in its TFR Directions Paper, considers the Rule change to be an appropriate mechanism to progress those suggestions. We agree with this approach. There is, therefore, no need to consider this proposed Rule change as part of the Commission's third strategic priority. Rather, the Rule change assessment should be informed by work undertaken in relation to the strategic priorities including the TFR.

Grid Australia looks forward to participating further in the Strategic Priorities Review. Should you have any questions in relation to this submission, please contact me on (08) 8404 7983.

Yours sincerely,

Rainer Korte

Rainer Korte
Chairman
Grid Australia Regulatory Managers Group