



10 October 2012

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

Dear John,

Re: Transmission Frameworks Review – Second Interim Report

SP AusNet welcomes the opportunity to make this submission to the AEMC's Transmission Frameworks Review Second Interim Report.

SP AusNet agrees that the review provides the opportunity to develop a more integrated approach to the planning and operation of transmission and generation. Arising from this review, a decision should be made on whether to progress further toward enhanced generator access arrangements. We support an advance in that direction.

The transmission service arrangements in Victoria, where network ownership is separated from the planning and investment decision-making function, are unique. The AEMC's proposals include a consistent integrated service provider model across the National Electricity Market. SP AusNet is able to bring the Victorian network owner perspective into this important phase of consultation.

For any enquiries regarding this submission, please contact Kelvin Gebert, SP AusNet's Manager Regulatory Frameworks, ph. 03 9695 6603.

Yours Sincerely

Alistair Parker
Director, Regulation and Network Strategy

Attachment:

Submission to Transmission Frameworks Review, Second Interim Report

Submission to Transmission Frameworks Review, Second Interim Report

1 Introduction

The MCE initiated the Transmission Frameworks Review anticipating that the introduction of climate change policies "...is likely to drive major changes in patterns of generation in the National Electricity Market (NEM) ...", and observing the challenges for transmission to support arising demands on its services. The Terms of Reference lead into the MCE's Direction to the AEMC for the review with the following paragraph:

"The AEMC's review should focus on identifying any inefficiencies or weaknesses in the inter-relationship between transmission and generation investment and operational decisions under the current market frameworks and amendments recently approved, having due regard for the limited time some of them have been in place. Where appropriate, the AEMC should recommend changes which would better align incentives for efficient generation and network investment and operation with a view of promoting more efficient and reliable service delivery across the integrated electricity supply chain".

Accordingly, the Second Interim Report proposes reform in three broad areas:

- generators' certainty of access to their regional reference price;
- planning frameworks; and
- arrangements for connecting to the network.

In particular, a change from a common carriage to firm access model for the NEM would be a major reform. SP AusNet supports the AEMC's objectives in presenting this alternative forward path. The remainder of this submission addresses the proposals for the broad areas noted above.

2 Current Victorian Transmission Planning Arrangements

2.1 Background

The transmission planning framework in Victoria was established at the time of disaggregation of the electricity sector in 1994, and included:

- The separation of the network investment decision maker from the network owner. These arrangements have continued to the present time, with AEMO now responsible for investment decisions for new augmentation (the independent planner) and SP AusNet owning, operating and maintaining the transmission network.
- Provision for the independent planner to seek contestable bids from the market for new major transmission augmentation projects on a build, own, operate and maintain basis. Having been subject to competition these assets would not be regulated. Currently AEMO may run a competitive tendering process for new transmission assets.
- The planner was also responsible for the provision of transmission services to connected customers. Effectively AEMO procures the service in bulk from the owner (SP AusNet and any other owner that has been successful in the tendering process for new assets) and provides these to customers. AEMO is responsible for pricing

these services and billing the distributors and generators, and ensuring the required service is provided.

2.2 Rationale

The rationale for this arrangement was as follows:

- To avoid the perceived natural incentive for an owner/planner to make capital investment decisions to allow additional returns to be generated for the business;
- To introduce competition into the provision (build, own, operate and maintain) of new transmission augmentation projects and thereby reduce costs; and
- Allow privatisation of the transmission network business by ensuring that effective control was vested with an independent party responsible for providing the transmission services to customers.

2.3 Experience

It is worth questioning whether or not the original rationale remains appropriate and the intended benefits have been achieved. For example:

- It is not entirely clear whether or not the perceived concerns regarding over investment in the network is valid as privatised businesses have strong capital disciplines and alternative uses for capital. There is little evidence that this has occurred in practice, for example level of network augmentation in the privatised Victorian DBs, which are responsible for network decision making has been significantly less over an extended time period than their Government owned counterparts in the other States;
- The market for the contestable provision of services is very thin, particularly for the long term ownership of the assets. SP AusNet has been successful in all but two contestable transmission augmentation projects tendered by AEMO (and their predecessors) over the last 15 years. This raises questions as to whether or not the perceived cost savings arising in provision of these services has been actually delivered, noting that SP AusNet runs a competitive tendering process in a deeper market for the provision of major plant items and construction services associated with new transmission projects;
- The separation of the service provision to customers from the provider of the majority of these services has resulted in complex contractual relationships, confusion in the responsibility for provision of new services to third parties and risk mitigation approaches to ensure that AEMO is not faced with any risk associated with the provision of these services (since it does not have a balance sheet). The lack of strong commercial drivers and incentives on AEMO has the potential to result in a lack of commercial drivers on AEMO in providing these functions;
- There was no experience with an economic regulatory framework for networks at the time of separation. The national regulatory framework that has developed and continues to evolve has well-established transparent and accountable planning and investment processes and policy oversight. The current review being undertaken by the AER is designed to further improve the efficiency of network investment.

3 AEMC Proposed Transmission Planning Framework

3.1 AEMC Proposal

The AEMC has proposed a nationally consistent transmission planning and investment framework. The preferred approach is an integrated transmission network service provider model. The arrangement would most closely resemble the South Australian model, where AEMO has planning oversight responsibilities.

If the proposal were to be implemented it would require the Victorian transmission planning and investment functions to move from AEMO to SP AusNet.

The AEMC's reasons for favouring the approach are:

- Enhancement of the role of the national transmission planner (AEMO's present national planning role), including a greater role in reviewing transmission planning reports and regulatory investment test processes;
- Enhanced national coordination;
- Maintaining ownership and operation of transmission at the regional level. The AEMC notes that the approach makes best use of national perspectives and local knowledge;
- The NTP functions require a body distinct from the investment decision maker, which would be inconsistent with its current Victorian TNSP functions;
- Increased level of AER oversight of capital expenditure in Victoria; and
- Improved expert advice resource for the AER when conducting revenue determinations for all TNSPs.

3.2 SP AusNet Perspective

SP AusNet has operated within the current Victorian framework for around 18 years. It has operated reasonably well although SP AusNet has consistently put the view that there would be a number of modifications that would be necessary to streamline the approach if it were contemplated for national application.

For example we have found that the functions have a level of interdependence which makes the new connections process overly complex, leading to high costs and delays for customers and in some cases compromises to the network configuration. There are also questions regarding the appropriate separation of risks and the ability to define this in rigorous contracts, as the separation effectively makes two commercial separate entities responsible for the provision of transmission services, which is generally viewed as heavily integrated.

SP AusNet has considered the business implications the alternative integrated TNSP model, taking into account the different opportunities and risks that would arise under the alternate model. The conclusion reached is that SP AusNet would not be opposed to a change in this direction, providing it was fully supported by other stakeholders and that the necessary parties could work constructively to make the change effectively. However we recognise that this would be contrary to the policy direction previously established by the Victorian Government and is counter to the direction that would be preferred by AEMO. Consequently while accepting that this change may provide overall benefits SP AusNet is not advocating for such a change to occur.

4 Generator Access

4.1 AEMC Proposal

Throughout the AEMC Transmission Frameworks Review there have been polarised views on the need for firmer access. The AEMC has therefore presented a non-firm access (status quo) approach as one option, with the clarification in the Rules that this is the only access service that can be offered. The 2nd option is for optional firm access, discussed below.

The concept of ‘firm access’ or ‘financial transmission rights’ has been debated in the NEM for many years. The concept allows generators to have a defined level of service, or access to the market which they pay for. In the event that a generator is constrained by a level of access that falls below the level they have contracted for then they would receive compensation. The intention of this is to ensure that they would be in the same financial situation as if the constraint had not applied.

Generators would be able to choose whether to have firm access. Firm generators would need to fund the incremental cost of providing access to the regional reference price (RRP). When constraints bind, firm generators constrained from accessing the RRP would be compensated by non-firm generators.

TNSPs would be required to plan and operate the network to deliver contracted firm access. If they failed to do so they would fund some of the shortfall in compensation to firm generators which would result. Although the AEMC has not indicated a preference for the firm access option it discusses key shortcomings that the proposal may address, leading to a more efficient wholesale energy market.

4.2 Rationale

The benefit of ‘firm access’ is that it provides stronger incentives on parties to arrange for the level of access that they require. Generators may need to fund the cost of the network investment necessary to underpin their required level of firm access, but if they do they have the rights (financial) to use this level of access regardless of the actions of other parties. In particular this also provides an appropriate signal to generators making an investment decision as they will be faced with the cost of meeting any upgrades to the network to allow the required level of access to be provided. Under the current transmission pricing rules there are very limited signals provided for locational decisions of new generators.

The proposal also provides incentives on the TNSPs to ensure that the contracted level of firm access is available to the generators. In the event that there is insufficient network capacity available to provide the required level of access then the TNSP would be required to compensate the affected generator. This may arise as a result of a transmission outage (planned or unplanned), or as a result of inadequate planning failing to maintain the level of capacity required in the long terms.

Regardless of the reason this provides a strong incentive for the transmission networks to provide and maintain the required level of capacity. This includes incentives for:

- Planning outages for times which are unlikely to impact the market significantly;
- Ensuring that the transmission network is reliable through appropriate maintenance expenditures; and
- Investing in new capacity where this is required to maintain the level of access following natural erosion of the capacity through load growth or other impacts.

Arguably a 'firm access' regime sits more comfortably with an integrated planner/owner transmission network service model as financial accountability and incentives may be more readily apply to the service provider. The current Victorian model, where AEMO is responsible for providing and charging customers and generators for transmission services, would significantly dampen any of the incentives on the transmission network. As AEMO is a not for profit entity it cannot be exposed to the financial impacts relating to the provision of transmission services. Ultimately there would need to be a form of true up mechanism which would blunt the intent of this incentive.

4.3 SP AusNet Perspective

SP AusNet has consistently favoured the provision of stronger incentive regimes for all its network operations. While this approach would provide stronger risks and incentives on the transmission owner than currently exists SP AusNet believes that it represents a key step in clarifying accountabilities for the provision of services in the NEM and would ensure that incentives are provided to the parties that are in the best position to influence the overall market outcomes.

The AEMC has presented an 'optional firm access' model that demonstrates the main features of a firm access regime including rights and obligations, risk allocation, market transactions and the basis for network service provider incentives. However many questions remain. It is likely that a significant amount of work is necessary to develop a practical scheme, and significant modelling will be required to understand the potential impacts on the business before SP AusNet could fully endorse the arrangement we consider that the development of a fully detailed practical model, including trialling is worth pursuing to confirm its merit in adding further benefits to the NEM.

5 Transmission Network Connections

5.1 AEMC Proposal

The AEMC has concluded that the Rules provisions lack the clarity necessary to facilitate the negotiation of efficient and timely connections. The AEMC proposes to overhaul the Rules provisions to improve the effectiveness of the connections process.

Most significantly, two changes in approach on new 'customer initiated' assets are proposed, giving the customer additional options. The customer would be able to influence the choice on which tenderer wins the bid to construct (but not own) shared network assets. The customer would also have the option of requiring a TNSP to provide a network extension, as a negotiated service (in reality this means 'fair and reasonable' which would not exceed regulated rates of return).

5.2 SP AusNet Perspective

SP AusNet has commented in this submission on the complexity of the connection process in Victoria. This involves tri-partite negotiation of contractual arrangements to define the arrangements for service provision. The connection applicant has service contracts with both AEMO and SP AusNet, and contracting is also required between AEMO and SP AusNet. For one new generation connection, mapping of the arrangements reveals 23 executed documents. This is reflective of the complexity of the triangular arrangements. The arrangements also reflect the need for AEMO to ensure that all risk is assigned away to the connection applicant and network owner. This level of inflexibility is inherent in the structural arrangements.

The direct flow on impacts of the process are the extensive period required to reach agreement on the terms of connection, and the very high legal cost accruing to the

parties, i.e. to the connection applicant and the incumbent network owner. As the costs can be so high AEMO's legal costs are typically met by the connection applicant.

The AEMC proposes that the negotiation of augmented shared network services be conducted on an 'open book' basis. The AEMC will need to be mindful that such an arrangement will lead to another form of tri-partite negotiation (as the tender process is included), and attendant difficulties. SP AusNet supports a transparent negotiating process, but considers that the AEMC's proposal may not advance timely investment in the industry. We would therefore suggest that a level of transparency be required that includes consultation with the proponent on the asset specification, and for agreement to be reached on the pricing model, asset delivery method adopted by TNSP (e.g. open tender) and project performance reporting.

SP AusNet does not agree that TNSPs should be required to provide network extensions as negotiated services. The potential cost of a network extension could run into hundreds of millions of dollars. The investment is unlikely to be foreseen in the TNSPs investment planning and financing plan and therefore potential constraints on its ability to obtain finance, and the cost, may have serious impacts for the business.

The proponent is best placed to manage these risks, as part of its investment decision. Experience to date appears to be that proponents are willing to take responsibility for establishing the transmission infrastructure necessary to transport their energy to the proximity of the network. TNSPs would be encouraged to participate in a non-regulated process directed by the proponent.