15 October 2012

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235
Submission lodged online at: www.aemc.gov.au

Project Number: EPR0019

Dear Mr Pierce

Submission to: Transmission Frameworks Review Second Interim Report

The National Generators Forum (NGF) welcomes the opportunity to comment on the AEMC's *Transmission Frameworks Review, Second Interim Report,* as released on the 15 August 2012.

The NGF is the national industry association representing private and government owned electricity generators. NGF members operate across all states and territories and all generation technologies, including coal-fired plant, gas-fired plant, solar, bio-waste, hydroelectric plant and wind farms.

The NGF appreciates that the objective of the Transmission Frameworks Review is "to create a flexible framework to deliver the most cost efficient investment in electricity generation and transmission in the future". In the Second Interim report the Commission sets out two alternative paths to achieve this objective. One path reflects the existing market arrangements. The other path involves fundamentally changing the current market by introducing an Optional Firm Access (OFA) model.

The NGF remains strongly supportive of the NEM's existing market arrangements and contests that the identified problems with the current arrangements are, at best, small and the proposed solution expensive and risky. The following summarises the key messages from a report prepared by Frontier Economics, on behalf of the NGF:

NO EVIDENCE OF A PROBLEM

There is no evidence that the current arrangements are failing and that changes would improve market outcomes. Evidence of a market failure has not been uncovered as part of the review process. This review covers the same issues as previous reviews which recommended incremental changes to the existing arrangements.

Investment and operational decisions are driven by a mix of factors, with transmission low on the list. Given the structure and geographical characteristics of the NEM, access to fuel and water along with other portfolio considerations are the key drivers. More importantly, investors already need to account for likely future transmission development to ensure they can deliver their product to market.

ENERGY COSTS COULD RISE AND RESULT IN UNINTENDED MARKET IMPACTS

The AEMC has formed the view that the OFA model will improve the level of contracting in the market. Our analysis suggests that the additional risk created by uncertainty around securing firm access and the possibility of funding compensation are likely to be reflected in higher contract pricing and reduced volumes traded. This should be of major concern for end consumers as the majority of energy is settled and agreed through Contracts.

The NGF believes the economic impact of disorderly bidding is, at best, small and generally immaterial. The AEMC has stated that the OFA would effectively be a form of congestion management which would remove disorderly bidding. The NGF strongly disagrees with this view and believes that disorderly bidding would still be present within the OFA model.

Furthermore, we are concerned that the proposed pricing methodology will not deliver efficient and transparent transmission pricing foreseen within the Second interim report. Contrary to the Commission's view the OFA is not a market led approach and relies on networks companies' views on future generation development. This would lead to increased centralisation of decision making.

Finally, sunk transmission costs should be recovered in a way that minimises impact on production and consumption decisions. Application of the sunk costs to consumers is unlikely to impact consumption and utilisation of the network whereas the same charge applied to generators would materially distort efficient energy consumption and dispatch. Furthermore recovering sunk transmission costs from generators does not have any locational signalling function because the capital cost has already been incurred and subsequently cannot influence future behaviour. The NGF therefore considers that the current transmission pricing framework for recovering sunk transmission costs from consumers is appropriate.

THE NEED FOR A FULL COST-BENEFIT ANALYSIS

Without a full analysis of the costs and benefits of the OFA model, the NGF believes it would be poor regulatory practice to even recommend an alternative market arrangement.

The OFA model theoretically has some appeal. However analysis presented in the Second Interim Report has been simplified to a radial (point to point) transmission network. In reality, the NEM is a long and meshed interconnected transmission system across five states. The NGF asserts that it is insufficient to recommend major reform based on a theoretical view of market efficiency which have not been tested anywhere in practice. Any perceived benefits must be balanced against the real uncertainty a new highly complex regime introduces particularly for a sector already adjusting to the new carbon tax. This risk is in addition to the significant implementation costs.

The NGF engaged Frontier Economics to perform an analysis of the OFA model. Their attached report forms a key part of the NGF response to this Review. Frontier's analysis can be summarised as:

1 There will be increased centralisation of decision-making under the OFA proposal. The greatest drawback of the OFA proposal concerns the methodology for pricing firm access rights. This methodology is both extremely complex and abstract, and implies a profound centralisation of decision-making power over the planning of, and investment in, new generation and transmission infrastructure compared to the present arrangements. Such centralisation flies in the face of one of the key claimed benefits of the OFA proposal – that it represents a 'market-led' approach to development of the transmission network

that should achieve a higher level of co-optimisation between generation and transmission development.

The locational signals provided under the current transmission planning arrangements are more powerful than is commonly assumed. These signals arise through the operation of the RIT-T, including participants' expectations of how the RIT-T will be applied in future. The RIT-T process already assures a high level of co-optimisation between generation and transmission development.

2 The OFA proposal gives rise to a number of interdependent concerns about appropriate governance and good regulatory practice.

3 The OFA proposal is unlikely to achieve more deep and liquid derivative contracting and is unlikely to eliminate non-cost-reflective generator bidding behaviour.

The NGF felt compelled to perform a technical critique of the OFA model primarily due to the fact the Commission has delved straight into developing the OFA model in detail and has consistently highlighted its attractiveness in addressing a set of perceived current market "problems". This reluctance to technically critique the OFA model is due to the fact the NGF firmly believes that the Commission has not sufficiently answered the fundamental question of whether there is a material problem with the current market arrangements which would then warrant fundamental market re-design through the OFA model. This technical critique is attached as part of the NGF submission.

The NGF notes that a number of States have initiated reviews to improve the efficiency of network businesses. Moving forward, the appropriate course of action would be to understand the impacts any recommendations will have on network planning and operation before fundamentally redesigning the market.

The NGF believes the existing market arrangements have promoted a deep and liquid contracts market. In any market design there will be competing trade-offs.

The NGF recognises that some level of disorderly bidding does occur but the key question remains the materiality and economic cost of this practice. The NGF has in prior submissions provided evidence that the economic cost of disorderly bidding is immaterial and tends to be transitionary as transmission constraints are built out. There is also no evidence that under current market arrangement that there is systematically poor coordination of transmission and generation investments.

The NGF remains supportive of incremental improvements to the current market arrangements which the NGF articulated in its submission to the First Interim Report. All these factors support the NGF's view that there is no economic case to radically change the current market arrangements to an OFA model.

I will be in contact to further discuss these issues.

Yours faithfully

Tim Reardon
Executive