Statement by Dr Robert Booth, Bardak Group

to the ACCC Pre-Determination Conference

on TransGrid's Revenue Requirement

March 18th 2005

Mr Chairman

Thank you for the opportunity to make this presentation to the ACCC. It has been some time since I appeared at a Pre-Determination Conference, and it is good to be back.

I stress that I am not acting for anyone on this — I am commenting as an expert but independent commentator on energy matters, which seems to be my role in life these days.

I wish to make a series of general points in the time allotted to me. These all relate to the major spine or backbone of transmission in NSW, rather than the whole range of TransGrid's operations, and in particular, the part of their network which forms a logical part of the missing National Grid.

Role of Transmission

Firstly, it seems to me that, after many years, we have finally settled on the proper role of transmission in the National Electricity Market — after an entirely wrong-headed flirtation with Market Network Service Providers, which has confused the situation for some seven to eight years now.

Why we went down that path was always beyond me, since calculations one could do on the back of an envelope, showed that either we embedded permanent price differentials of up to $15/MWh between the NEM regions — thus completely ruining the concept of a National Market — or common sense would prevail and the owners of such links could not possibly ever make a profit.

In the end it was the latter situation which prevailed, but we have been left with a lack of interconnection capacity into critical areas — like South Australia — and with expensive and sub-optimal transmission links. I noted, Chairman, that in the middle of the blackout in South Australia last Monday, when half of SA was without power and support was desperately needed, Murraylink contributed just 50MW — less than 25% of its rating. It was pretty useless.

A strong essentially free-flowing transmission system, regulated efficiently, delivering bulk power when it is needed, and facilitating competition between generators, is what we need.

The Need for a National Grid

I am old enough to have been around and involved in the Special Premiers' Conferences of 1990 and 1991, and the investigations that preceded them.

The States and the Commonwealth agreed to form a "National Grid" so that the cheapest sources of power could be developed and utilised irrespective of State boundaries. They even resolved that the States should secure easements for the strong transmission lines that would be required. All very sensible and logical.

But we rushed into forming a "National Market" before we built the underlying infrastructure necessary for it to work properly — the National Grid.

As Parer and others have noted, we do not have a true National Market — we have a series of regional markets which generally operates as one, but all too often breaks up into regional markets, with large price differentials between them.

In my view, we need to return to the simple, logical approach that we once took on such matters, and which incidentally led to the construction of QNI by inter-Government agreement — not under the NEM processes. We would probably still be waiting for it had they applied. And not only did QNI pay for itself in less than six months, it saved NSW and the NEM from major cascading failures twice in the latter half of 2005. On the other hand, the weak and rather fragile interconnections into South Australia failed to prevent the blackout last Monday.

We need a National Grid for the simple reason that there is and never will be, enough independently owned generating companies in Australia to get vibrant competition in the generation sector. We will never have the 250 participants that PJM has, or the same order in Scandinavia. And we cannot expect the level of divestment and new investment that has given the UK — once a cosy duopoly and then a cosy triopoly — a very competitive generation sector.

And while not the subject of today's conference, I must state that this level of concentration of ownership is particularly worrying when one operates a compulsory, energy-only pool, with its well know propensity for price manipulation.

And there is a clear tendency — through the merger and acquisition activities in Victoria and South Australia — for an increase in concentration of ownership and the unwinding of the carefully constructed level of competition put into place in Victoria to maximise competitive pressures. I was involved in those discussions and I do not like what I am now seeing in those two States.

And both privatisation and greater disaggregation of generation is off the agenda in both NSW and Queensland. And State Governments show no inclination to give up the direct and indirect influence that they exert over the Government Owned Corporations.

It we cannot get greater structural and ownership diversity, then the next best thing is to ensure that those generators we do have all compete in the same market, and do not have the opportunity to break it up to exploit market power in smaller regions.

Mr Chairman, I want to make a plea for a return to the concept of a National Grid today, and the ACCC has a very important role to play in this, but one which it is not playing at the moment, as I shall set out.

The Cost of Transmission and of a National Grid

The cost of all this is very small and can readily be justified in simple terms.

The average cost of transmission in the NEM is only about $7/MWh (only $5.8/MWh in NSW, I notice) — out of an average tariff level of around $100/MWh. Barely 7% of the total. By comparison, cost of distribution can be as high as $35/MWh and the effective wholesale cost — all elements included — can be as high as $60/MWh.

We clearly should be focussing attention more on minimising distribution costs and making sure that they are at efficient levels, and doing far more to ensure that wholesale prices remain fair and reasonable for both generators and end users — in particular by encouraging greater competitive pressures and also by reducing the excessive level of risk that we have in the present market.

Last year, following the publication of the Statement of Opportunities which included the first version of the ANTS statement, I conducted an exercise where I took the largest and most expensive interconnection projects listed in the ANTS — essentially 1400-2000MW HVDC links from Queensland to Bayswater and from Marulan in to Victoria and South Australia. Note that this route utilises the western 500kV ring around Sydney, treated as an "excluded project".

Using the capital costs quoted in the ANTS, reasonably levels of WACC and asset lives and typical O&M costs, I calculated that to build this National Grid — one that would probably satisfy me — would add only a little over $1/MWh to the average transmission charge in the NEM — 1% of the average end-user tariff.

But if this investment only eliminated a few of the price spikes which drive up the average pool and therefore contract prices, a reduction of more than $1/MWh in a total which can reach $60/MWh, is, in my view, a lay down miséré.

We would save money over all.

Compare us with Overseas Practices

If I compare our approach to new major transmission investment in interconnections with that of overseas countries, I find a stark contrast.

Through the process that we are engaged in today, and the complex, obscure and almost unintelligible Regulatory Test process (at least to normal human beings), the ACCC and the NEM rules make it almost impossible to justify new investment in interconnections.

In the USA, FERC is offering to add a percentage point or so to the return allowed on new major transmission assets which remove current bottlenecks to power flow. And in Europe, the EU is leading a program to remove transmission system limitations between countries to encourage the free flow of electricity, and backing it up with the promise of financial assistance. They both have come to recognise the importance of creating strong interconnected, essentially free- flowing transmission systems to facilitate trading and to lower the cost of electricity to their communities.

We need to get back to that kind of thinking.

The ACCC Approach to TransGrid

What do I see in the current ACCC approach to TransGrid's revenue requirement?

First, I see extreme detail — far from the concept of "light-handed regulation" that we are supposed to have.

Second, I see a danger that ACCC is effectively setting itself up to be the system planner for NSW, by excluding major projects and requiring that they be separately justified when the need can be firmly shown. With great respect to those present, the ACCC does not have the expertise to do this job properly, and relying on external consultants is this area is really problematic, as few consulting firms have the hard-nosed experience in transmission planning to be able to make informed and sensible judgements on what are, essentially, long term strategic assets of national importance.

Third, I see real danger of "short-term-ism" creeping in, where the five year regulatory period prevents decisions being made on major assets which have effective lives of forty or fifty years. The exclusion of small expenditure on easement acquisition is a classic example of this. Unless easements are acquired 10-15 years in advance, the transmission lines will not be able to be built — they are like taking out an option for future expansion.

Fourth, I see the real chance of a mess like that we have made for ourselves by supporting MNSP's, where decisions are delayed and delayed, where bottlenecks and problems are patched up and patched up again, and we end up with poorly optimised and utilised transmission systems, too many low voltage lines, delays in construction, continuing transmission constraints, and so on.

Put into Boxes

The ACCC approach is to put major expenditure, especially that on the 500kV ring from Bayswater to Marulan — which I regard as being both essential to NSW and essential to the National Grid— into a box, labeled "Excluded".

I agree with putting the major projects which make up the spine of both the NSW and the national market into a box — but I would label it "Urgent — to be encouraged".

I would even go further and, as a consumer of electricity, allow TransGrid a higher rate of return on these specific major assets, due to the benefit that the whole National Market gets from them. They should be cleared for action and actively encouraged, not discouraged, as is the effect of the Draft Determination.

Closing Remark

In closing, Chairman, I am making a plea for the ACCC to take the lead in promoting the National Grid that we were once promised but which has never been delivered.

It is probably the most important step that we have available to us to address the lack of competition in the generation sector of the electricity industry. It will bring undoubted public benefits at minimum or no net cost to customers

Thank you, Mr Chairman.