

8th August 2014

Mr Chris Pattas
General Manager - Networks Branch
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Submitted via email: TransGridrevenuereset@aer.gov.au

Dear Mr Pattas

TransGrid - Determination 2014-2019

The businesses listed on the side bar (the Generators) appreciate the opportunity to comment on TransGrid's Revenue proposal for 2014/15 – 2018/19.

Before providing specific comment on TransGrid's revenue reset application it is relevant to establish the contextual factors in the NEM which should be key factors in determining an efficient level of investment and expenditure for network service providers.

Contextual Factors – Energy Consumption and Peak Demand is Falling

Electricity consumption has been declining since 2008 and the rate of decline appears to be accelerating. Demand for electricity in Australia is now around 10% lower than in 2008 and the same level as in 2004. This decline in demand is unprecedented in Australia's post war history.

Falling energy demand from manufacturing and industrial sectors in the wake of a high dollar and international competition for investment has been the main driver. Residential energy demand has also declined in response to rising network costs forcing up the retail price of electricity. Weather variations do not explain the sustained decline in electricity energy demand.

As highlighted in Figure 1 below the forecasts of energy consumption for the electricity sector has been slow to recognise this paradigm shift in demand for electricity.

Delta Electricity

Snowy Hydro

Stanwell
Corporation

ERM Power

Hydro Tasmania

Energy Australia

GDF Suez Australian
Energy

Alinta Energy

Origin Energy

CS Energy

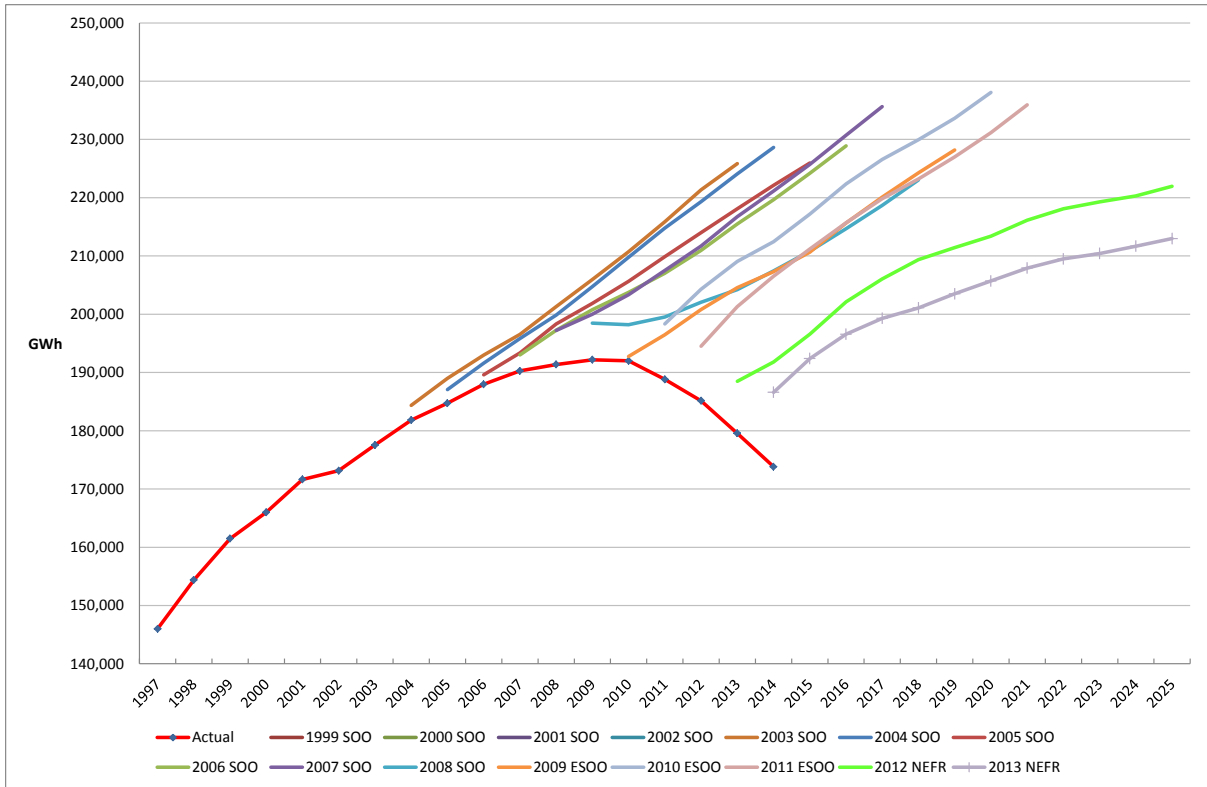


Figure 1: Actual energy consumption and forecasted energy consumption for each year from 1999 to 2013.

Despite the obvious trend in actual energy consumption the latest AEMO National Electricity Forecasting Report (June 2014) forecast the NEM annual energy outlook to grow at 0.4% per annum to 2016-17.

Peak demand is falling due to a number of factors such as increase energy efficient appliances and increased customer awareness. Network businesses have already invested in assets to meet forecasted increases in peak demand that has not eventuated.

Analysis from the Grattan Institute illustrates this clearly. Figure 2 below shows how peak demand for the 2012-13 year compares to historical peaks in each state of Australia. The fall in peak demand ranged from three per cent in Western Australia to more than nine per cent in Tasmania¹.

¹ Grattan Institute (Dec 2013), Shock to the system: dealing with falling electricity demand, page 15



Figure 2. Source: The Grattan Institute, Shock to the system, Dec 2013

The Generators concur with TransGrid observation that there has been unprecedented change in the NEM²:

The five years since TransGrid’s last revenue proposal have seen a time of unprecedented change in the electricity industry. At the time of lodgement of the last revenue proposal the recent level of economic uncertainty had not been anticipated, a less ambitious renewable energy target applied, take-up of energy efficiency initiatives was minimal and solar bonus schemes in New South Wales and the Australian Capital Territory had not commenced.

We commend TransGrid for deferring over \$600 million of capital expenditure in response to changes in electricity demand patterns. However, as outlined earlier the NEM in recent times has continually experienced overall optimistic energy and peak demand forecasts. Hence we advocate a scenario modelling approach where the probability of falling peak demand is given more weight in the assessment of capital expenditure programs.

The Generators also acknowledge that TransGrid have decreased the amount of proposed “load driven investment” from previous proposals, reflecting the commentary above regarding the changing nature of the NEM. We would encourage TransGrid and the Regulator to further scrutinise the proposed replacement expenditure to determine whether further capital deferment could occur with regard to the updated demand forecasts from the 2014 NEFR.

² TransGrid Revenue Proposal 2014/15 – 2018/19, page 4

Demand Management

TransGrid has proposed a demand management innovation allowance of \$3.6 million per year on average in the upcoming regulatory control period.

The Generators support initiatives to encourage efficient demand side response at times of system stress. State government retail price regulations have restricted demand response occurring in the past and contributed to expenditure on networks to ensure reliability during these peak events.

We are however concerned with allowances for demand management when it is already part of the TNSP's obligation to seek demand management proposals as alternatives to any capital expenditure. Further to this the wholesale market design already caters for Demand Response where it is economic.

Pre-emptive Network Support

TransGrid's approach to the Powering Sydney's Future project requires more rigorous assessment. The project outline proposes \$28.6 million be spent over four years procuring network support services "pre-emptively". These services are not required within the four year period but will serve only to develop a market for services in the future. This is a significant departure from accepted practice and should be critically examined by the AER.

TransGrid's own uncertainty about the timing of the project is enough to call into question the wisdom of spending consumer's money pre-emptively on network support services. The project has been classified as contingent and involves a very large network support services component precisely because TransGrid is uncertain about the timing of the requirement. AEMO's most recent connection point forecasts highlight the reason for the uncertain timing. Recent demand trends in the Sydney CBD area are clearly negative, while forecasts are for strong growth (figure 3). These trends are difficult to reconcile. Any delay in the return to growth will see the pre-emptive network support services sunk and making no contribution to the reliability of the network.

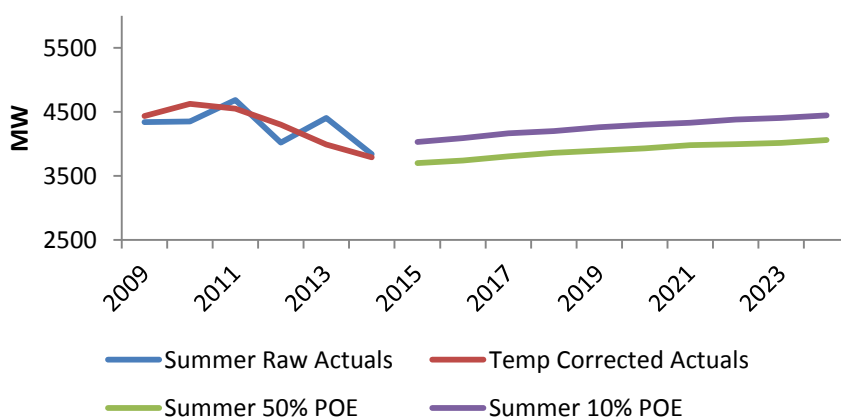


Figure 3: AEMO Sydney CBD Group Connection Point Forecast (2014)

TransGrid uses straight line interpolation to generate annual targets for the quantity of pre-emptive services to be procured (Figure 4). With no need for these services during these years a straight line approach gives large surpluses prior to the actual requirement. A more commercially acceptable approach would see market development start, if at all, much later with a much faster ramp up to the forecast requirement in 2018/19.

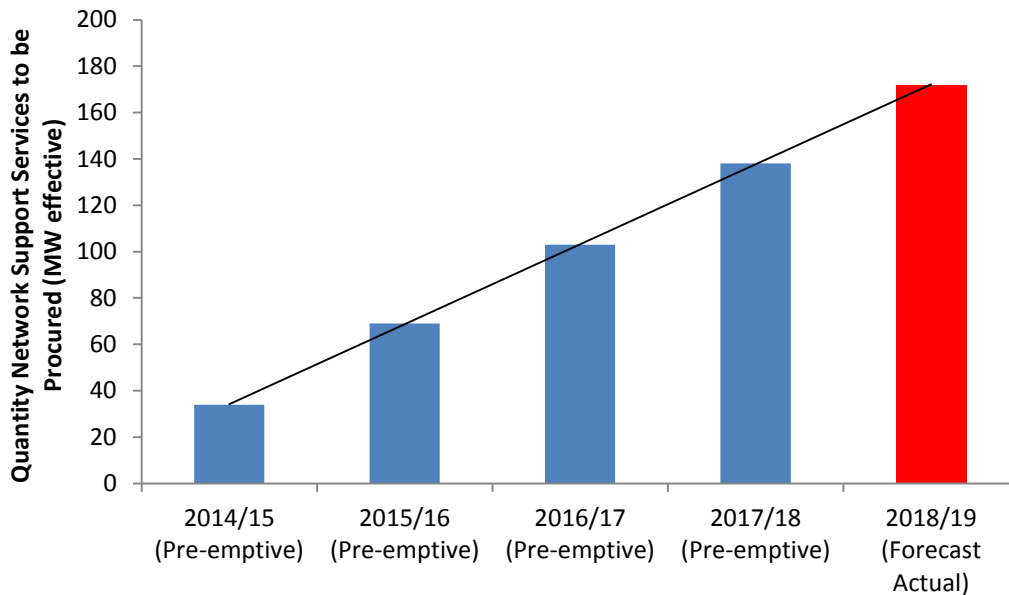


Figure 4: Straight line development of pre-emptive network support services market (source: TransGrid)

The risk surrounding the development of a market for network support services should be borne by TransGrid, not consumers. The risk to consumers here is magnified by TransGrid’s proposal to include energy efficiency projects in the definition of pre-emptive services. By spending money on this type of network support service, TransGrid would be locking in future demand reductions that would not be needed should the forecast requirement not eventuate.

Fundamentally, the Generator’s believe that it is not TransGrid’s core business to create a market for demand response services or energy efficiency projects and the working group does not support the pre-emptive approach to procuring network support services on the basis that there is significant risk that consumer’s funds being spent for no benefit to network reliability. Any money to be spent on network support services to delay a transmission construction project should be evaluated as part of the RIT-T assessment of the transmission build and the risk that network support services will not materialise should be considered within that RIT-T assessment.

Management of Stranded Assets

TransGrid has considered the possibility of stranded network assets due to recent declines in electricity demand and growth in embedded generation such as domestic roof solar panels. TransGrid states³ that:

If assets progressively become stranded over 20 to 30 years TransGrid would be able to respond by:

- *relocating high voltage equipment to replace other equipment requiring replacement, avoiding the procurement cost of new equipment;*
- *reusing or recycling other substation infrastructure such as steelwork; and*
- *selling property or making it available for other infrastructure such as community electricity storage.*

Another option for the AER and TransGrid to consider was expressed by AEMO in their 2013 NTNDP section 3.4 Asset retirement consideration. AEMO states in this section that:

Depending on excess capacity in the network and the estimated local consumption it serves, it may be more cost effective to replace it with one of the same capacity, a lower capacity, or completely retire it.

Incentive Schemes

The National Generators Forum (NGF) submission⁴ to the AER on the revenue determinations for 2014-2019 of the NSW Distribution Network Service Providers outlined a number of issues relating to application of the new incentive schemes in light of past decisions to approve dramatic increases in capital and operating expenditure for distribution network businesses. As noted in the report, it is important that incentive schemes are strong enough to reveal efficient costs, while at the same time not rewarding Network Service Providers for past, and potentially ongoing, inefficiencies.

The observations outlined in the NGF submission for the Capital Expenditure Sharing Scheme (CESS), Efficiency Benefit Sharing Scheme (EBSS), and the Expenditure Forecast Assessment Guidelines are equally applicable to the AER's assessment of TransGrid's revenue proposal.

³ TransGrid revenue proposal 2014/15-2018/19, page 44.

⁴ NGF submission to the AER on the revenue determinations for 2014-2019 of the NSW Distribution Network Service Providers, dated 27 June 2014.

Concluding Remarks

The Generators support economically efficient transmission investment and appreciate the opportunity to comment on this Revenue Reset proposal.

Should you have any questions or wish to discuss this submission further, please contact Kevin Ly on (02) 9278 1862.

Yours sincerely,

A handwritten signature in black ink that reads "D. Bowker." The signature is written in a cursive style and is underlined with a single horizontal stroke.

David Bowker
On behalf of the listed generators