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Dear Sebastian

ACCC SUPPLEMENTARY DRAFT DECISION FOR TRANSGRID

Macquarie Generation has a number of concerns with the ACCC's *Supplementary Draft Decision for Transgrid* released on 3 March 2005. Macquarie Generation believes that the draft decision fails to adequately take account of key benefits from transmission investment, namely:

- the effect of a free-flowing, open-access transmission network in promoting competition;
- the impact of network congestion on consumers, business and the community; and
- the importance of timely planning decisions, in particular land acquisition and the development consent process.

Promoting competition

The Ministerial Council on Energy has identified three key roles for the transmission system: "*it provides a transport service from generation source to load center, facilitates competition and ensures secure reliable supply*".[1]

Macquarie Generation believes that the analysis supporting the ACCC's draft decision ignores the likely impacts of transmission congestion on the energy market and the consequent effect of network constraints on the level of competition between generators.

The Corporation's main objection to the draft decision is the treatment of the key transmission infrastructure that delivers energy to the Sydney load centre – the "500 kV ring". In an effort to limit transmission use of system charges payable by customers, the ACCC has deferred crucial capital expenditure. This infrastructure is essential to maintain access for generators in the Hunter Valley, Western Region and Snowy to the Sydney market. Without investment in these transmission assets, it is inevitable that the level of congestion on the network will increase.

[1] Ministerial Council on Energy, Report to Council of Australian Governments on Reform of Energy Markets, 11 December 2003.

The presence of binding transmission constraints in the NEM will reduce the level of competition between generators and may create the conditions for those generators on the load side of the constraint to significantly increase wholesale prices. Outcomes in the Queensland market when the Tarong constraint is binding provides a good case study of possible price impacts.

Benefits to consumers

Transmission use of system charges represent a relatively minor component of the bundled retail price paid by customers. A typical NSW residential customer spends about $1,000 per annum on electricity. Delivered cost of electricity to those customers is made up of the following costs:

- Distribution network charges 50%
- Cost of electricity 40%
- Transmission network charges 5%
- Retail margin, green energy costs and market fees 5%

The ACCC's draft decision reduces the increase in transmission use of system charges by about $0.40/MWh over 5 years by excluding some $900 million expenditure on major augmentation projects. This saving represents about 0.3% of the final retail price, equivalent to $3 a year or 6 cents a week for the typical residential customer.

The ACCC's draft decision does not take account of the potential impact of transmission congestion on expected energy market price outcomes. Network congestion that results in one hour of spot prices at VOLL in a year would increase the energy price by more than $1/MWh or about 1% of the final price paid by most customers.

Example: Impact of the Tarong constraint in Queensland

Cal Year 2001
- 143 half hours of binding constraint
- Increase in average pool price for the year = $0.42

Cal Year 2002
- 32 half hours of binding constraint
- Increase in average pool price for the year = $1.09

Cal Year 2003
- 4 half hours of binding constraint
- Increase in average pool price for the year = $0.39

To put the numbers into context, the ACCC is effectively assuming that transmission congestion in New South Wales will not result in more than about 30 minutes of VOLL over the 5 years of the determination.

PB Associates report

The PB Associates report assumes that major transmission upgrades can be deferred for two reasons:

- The consultants believe that generation investment will occur on the Central Coast – on the load side of potential congestion; and
- NEMMCO can constrain on generators to relieve network constraints

Scope for investment on Central Coast

Any new generation investment on the Central Coast will need to accommodate a range of planning, environmental and resource issues:

- Air shed
- Fuel
- Water
- Land

Apart from the redevelopment of the Munmorah power station as a gas-fired operation, there is very little prospect of any new generation investment on the Central Coast. This is primarily because of the growth in residential development in the area and the likely difficulties in obtaining appropriate sites and development consents. Even the proposed Munmorah project would only cater for 1 or 2 years of growth in peak NSW demand.

Constrained on generation

The NEM is an energy-only market where spot prices are meant to elicit appropriate supply and demand responses. Constraining on generation is totally inconsistent with this design as the system operator can dispatch generators on the basis of physical system requirements not on the basis of generator bidding. Under current arrangements, constrained-on generators often receive a wholesale price below their offer price for that volume of energy.

A generator exposed to the risk of constrained-on dispatch may alter bidding behaviour to minimise potential losses. For example, a generator may declare itself unavailable during periods of congestion to avoid dispatch. Transmission planning should attempt to minimise the need for constrained-on generation, not rely on this practice as a way of meeting reliability standards.

Transmission development

Any new major baseload generation investment in New South Wales will require a secure and cost competitive fuel source, a site that is acceptable to the community, adequate water supplies and access to the transmission system.

Macquarie Generation considers that the next major baseload investment in New South Wales will occur outside the proposed 500 kV ring. Likely sites include:

- the Hunter Valley;
- Queensland over the Queensland-New South Wales interconnector;
- Mt Piper; and/or

– North Western NSW

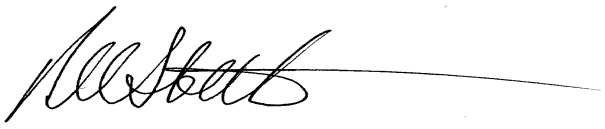
It would be unreasonable to expect that Transgrid could predict with any accuracy where and when new generation investment will arrive in New South Wales given the number of variables that influence investment decisions. But the risk exists that if Transgrid and the ACCC wait until investors commit to a project that it may not leave sufficient time to plan, develop and commission new transmission infrastructure. Uncertainty about access to the market may deter investors from undertaking the necessary work in planning and developing new generation projects.

Macquarie Generation believes there is a strong case to fund and initiate the early stages of the major transmission pathways. Of particular concern are the acquisition of easements and the completion of development consents. These are high risk but low cost activities. It is simply not possible to fast track these stages of development as transmission priorities emerge.

Conclusion

Macquarie Generation is of the view that the ACCC's final determination should give serious consideration to competition and energy price outcomes that will occur if network congestion increases. The Corporation believes that these congestion problems are inevitable if there is not sufficient forward planning for major elements of the transmission system that are needed to complement baseload generation investment. Without some coordination of these investment decisions, system reliability can deteriorate. At a minimum, the ACCC should allow Transgrid to undertake the early stages of transmission development including development approvals and easement acquistions. It is easier to create these options in advance than to force planning decisions on the community when congestion becomes a problem.

Yours sincerely



RUSSELL SKELTON
MANAGER, MARKETING AND TRADING

24 March 2004