



22 February 2013

Andrew Reeves
Chair
Australian Energy Regulator
GPO Box 520
Melbourne Victoria 3001

Heywood Interconnector Upgrade RIT-T Determination

Dear Andrew

The National Generators Forum (NGF) has a significant interest in investment within transmission and distribution businesses. We appreciate the important role networks play in delivering competitively priced, reliable and safe energy to Australian consumers and the need to ensure the regulatory settings provide incentives to deliver efficient network investment and operation. As such, we support investment in the transmission network, in particular interconnectors, where it is clearly demonstrated that the investment is efficient and customers will realise a benefit.

The NGF has been increasingly concerned with the spiralling costs of transmission and distribution networks and its impact on the efficient use of electricity by consumers and consequential impact on generators. The rising retail price of electricity has been a major factor, along with structural changes within the economy, leading to the decline in demand for electricity. The major cause of rising retail prices has been the investment in new and upgrades to network infrastructure. The generation of electricity now accounts for just 32% of the cost of supplying electricity to customers compared to 45% a decade ago.

For this reason, the NGF has closely monitored the progress of the Regulatory Investment Test for Transmission (RIT-T) for the South Australia – Victoria (Heywood) Interconnector Upgrade.

The Conclusions Report (December 2012) of this RIT-T finds that there are net market benefits from a range of credible options and recommends the installation of a 3rd transformer at Heywood, series compensation of existing 275 kV lines in South Australia and associated works. “The estimated commissioning date for this option is July 2016. The total capital cost of this option is estimated at \$107.7m (\$2011/12)¹.”

The Conclusions Report notes that ElectraNet will seek a formal determination of the RIT-T recommendation from the AER. Once a network upgrade is approved, the cost is included as an increased use of system charge to consumers for a considerable time with no redress for consumers in the event that the network upgrade was in fact inefficient, either due to cost increases or overly optimistic views on the benefits.

¹ South Australia – Victoria (Heywood) Interconnector Upgrade RIT-T: Project Assessment Conclusions Report, Page IX

The National Electricity Rules (NER's) provide for any dispute to the decision to proceed with this preferred option to be lodged with the AER by 22 February 2013.

As a key stakeholder in this process the NGF considered a formal dispute to this Proposal. In considering a dispute we note that the NER allows the AER to award the costs associated with any further analysis of the RIT-T assessment to the disputing party. In light of the open ended costs associated with such a dispute, the NGF will not make a formal dispute in regards to the Heywood Interconnector Upgrade. We note that the AER is currently inquiring into appropriate mechanisms to ensure that the consumer view is more fully considered as part of decisions on network revenue determinations.

Notwithstanding this decision, the NGF does wish to raise concerns with this proposal and to assist the AER in undertaking a thorough analysis of the merits of the RIT-T process and the determination of the Heywood Interconnector Upgrade Proposal.

The NGF was engaged throughout the RIT-T process and has raised a number of concerns regarding the PADR with the proponents which we seek to bring to the attention of the AER. In particular, the NGF wrote to the proponents and raised four major issues:

- the timeframe for the analysis and reliance of distant benefits;
- the use of out-dated and inaccurate demand forecasts in the majority of scenarios;
- the lack of detail on a number of key assumptions and sensitivities; and
- the inclusion of operating cost benefits associated with new generation investment without accounting for the additional network costs associated with supporting output from these sources.

We discussed these concerns with the proponents in detail on a number of occasions and the subsequent Conclusions Report provides significantly more detail in regards to these issues. In providing this detail however, additional concerns with the purported benefits arise.

Central to the outcome of the modelling are two key assumptions that the NGF believes should be exposed to further analysis. These are:

1. **The differential between Victorian and South Australian gas prices:** Gas prices in Victoria have been historically lower than in South Australia due to a range of market outcomes. The proponents assume that this differential will remain constant throughout the project life.

In recent years the east coast gas market has experienced significant changes in the market price for gas reflecting increased demand and constrained supply. Furthermore, as Australia moves to the expected export of gas from Queensland in 2015 it is expected that demand for gas will intensify. This could lead to significantly higher gas prices across the eastern states.

As a consequence the NGF believes that the scenarios considered should be tested to determine the likely benefits of the Heywood Upgrade in the event that the differential between South Australian and Victorian gas prices narrows, for example in a scenario where rising NSW demand is met by additional gas supplies from Victoria.

2. **Related network investment not costed in the modelling:**

The RIT-T modelling includes a number of additional network developments which may impact electricity flows over the Heywood interconnector:

- a new Ballarat-Moorabool 220 kV line upgrade occurs in 2016/17;
- the existing Ballarat-Bendigo 220 kV line is upgraded in 2016/17;
- new 275 kV supply to Riverland area in South Australia in 2025/26.

The Conclusions Report does not include the capital cost of these projects as an additional cost when it considered the possible market benefits of the Heywood interconnector upgrade. The NGF considers that the RIT-T should appropriately apportion the costs of these projects if they are necessary to increase transfers on the Heywood interconnector. We note that the proposed upgrade increases the capacity of the Heywood interconnector by some 190 MW in either direction, yet a large share of the market benefits is associated with the 460 MW of gas plant relocating from South Australia to Victoria. To realise the market benefits of potentially lower cost dispatch in Victoria relies upon not only the Heywood upgrade but the related transmission work including works to increase flows through Murraylink.

In the current market with declining demand for electricity it is difficult to foresee the need for additional generation in Victoria or to determine where or what fuel source these new generators may utilise. As a consequence the NGF would welcome further analysis of scenarios which include the costs of upgrading all relevant transmission infrastructure that impacts on flows across the Heywood interconnector.

3. **Improved demand forecasts:** The RIT-T relies upon the 2011 and 2012 AEMO demand forecasts which show a strong recovery in electricity demand growth throughout the modelling period. While the National Electricity Forecasting Report 2012 included a substantial downgrade in demand forecasts in the near term relative to earlier AEMO forecasts, we have witnessed further absolute declines in demand in Victoria and South Australia in the 2012-13 year-to-date.

There is no evidence that the recent history of declining demand will plateau and recover.

There has been a paradigm change in electricity demand since 2008, with substantial shifts in consumer behaviour in response to rising prices, structural changes in the economy (partly caused by the exchange rate), increased adoption of energy efficiency technologies and the uptake of decentralised generation (roof top PVs and solar hot water systems).

Should these changes persist, it calls into question the need for further substantial capital expenditure on large scale network augmentations.

4. **Updated carbon price modelling:** The RIT-T adopts the Australian Treasury forecasts of future carbon prices. The carbon price is currently legislated to increase until 2015 and then align with the price of allowances in the European Union emissions trading scheme.

Since the Treasury forecasts were prepared the Australian Government has made the decision to link the Australian carbon market with the European emissions trading scheme.

International exchange-traded prices for carbon have also fallen dramatically. We consider that a modelled scenario involving a carbon price which is significantly lower than that reported in Treasury modelling is justified on the basis of the decision to link with the European scheme and the substantial fall in permit prices internationally.

Moreover, without bi-partisan political support for a carbon price it would also appear reasonable to model a scenario/s with a zero price on carbon after July 2016 (when the interconnector upgrade is commissioned).

In light of these concerns we encourage the AER to undertake a detailed analysis of the Conclusions Report and consider the merits of plausible alternative scenarios.

Moreover, it may be prudent to defer a decision on this Proposal until more reliable demand forecasts for the electricity, gas and carbon prices are available. This delay will have an insignificant impact on the benefits that the proponents believe will accrue from the upgrade as they do not occur for X ?? years, but may have a significant impact on the proposed timing of the upgrade.

I will be in contact to further discuss these issues with you and your office.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Tim Reardon', with a stylized, cursive flourish extending to the right.

Tim Reardon
Executive Director