

5 April 2013

Mr Tom Leuner
General Manager Wholesale Markets
Australian Energy Regulator
Level 35, The Tower,
360 Elizabeth Street,
Melbourne VIC 3000

Via email: tom.leuner@aer.gov.au

Dear Tom,

RE: Heywood Interconnector Upgrade RIT-T

AEMO and ElectraNet welcome the opportunity to respond to your letter dated 13 March, in relation to the issues raised in correspondence to the AER from the National Generators Forum (NGF), Macquarie Generation and EnerNOC. As agreed, we are responding to all issues simultaneously with ElectraNet's application for a determination under clause 5.16.6 of the National Electricity Rules (NER).

AEMO and ElectraNet note that the deadline for disputes to the Heywood Interconnector Upgrade RIT-T has lapsed and no disputes were raised within the specified timeframe.

The AER has raised the possibility that it may consider the letters received in relation to the Heywood Interconnector Upgrade RIT-T in a compliance/enforcement context. However, in this regard, we note that none of those letters alleges non-compliance by AEMO or ElectraNet. They express different views about various aspects of the modelling and assumptions undertaken during the RIT-T process. By its nature, forecasting involves forming opinions and estimates of likely outcomes based on an interpretation of information reasonably available to the forecaster at the time.

The Project Assessment Conclusions Report (PACR) represents the opinions and estimates of AEMO and ElectraNet, based on the AER's own guidelines, input from expert advisers and an extensive consultation process. AEMO and ElectraNet consider that the Heywood Interconnector Upgrade RIT-T was conducted in accordance with the requirements of the NER and the AER's RIT-T guidelines.

The AER is obliged to use the PACR findings and recommendations in making a determination under clause 5.16.6 because the PACR is the outcome of a robust process under the NER and the AER guidelines.

The RIT-T process allowed for a further and final opportunity for stakeholders to dispute the conclusions in the PACR by raising a dispute with the AER. AEMO and ElectraNet would be concerned if the use of an alternative avenue of 'complaint' to the AER were to undermine the objectives of the new RIT-T framework.

Attachment A provides further information to clarify the assumptions and approach used in the Heywood Interconnector Upgrade RIT-T analysis, in response to the issues raised by the NGF, Macquarie Generation and EnerNOC in correspondence to the AER. To avoid repetition of information and ensure consistency, we have referenced the Project Assessment Conclusions Report (PACR) where possible.

We understand the AER will use this information in considering ElectraNet's clause 5.16.6 application.

AEMO and ElectraNet also welcome any further clarification from the AER for future RIT-T processes, and we would be happy to provide further assistance if the AER is considering any amendment to its RIT-T guidelines to address any of these issues.

Please contact either Ashley Lloyd on (03) 9609 8372 or Rainer Korte on (08) 8404 7983 for any enquiries in relation to this matter.

Yours sincerely,



Joe Spurio
Group Manager Network Development

AEMO



Rainer Korte
**Executive Manager Network Strategy
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ElectraNet

Attachment A

This attachment provides further information to clarify issues raised by EnerNOC, the National Generators Forum (NGF), and Macquarie Generation (MG) in relation to the Heywood Interconnector Upgrade Regulatory Investment Test for Transmission (RIT-T).

Treatment of costs of demand management (DM) options under the RIT-T

EnerNOC raised an issue in relation to the treatment of DM costs under the RIT-T. Contract costs provided by EnerNOC and included in the RIT-T reflected a per MW availability fee and a per MWh dispatch fee. Details are in sections 3.3 and 6.1 of the PACR. EnerNOC expressed the view that the RIT-T assessment should not treat *all* the availability fee as forming part of the cost of the DM option. EnerNOC considers not all of this cost represents an economic cost, with approximately 50% typically being passed through to electricity consumers as a ‘wealth transfer’, or payment above reasonable economic profit.

The current RIT-T provisions do not permit the approach suggested by EnerNOC. The RIT-T requires that the:

- Net economic benefit is defined as equal to the market benefit less costs.
- The costs are the “present value of the direct costs of a credible option¹” and that this is to include the “costs incurred in constructing or providing the credible option²”.

ElectraNet and AEMO note that the reference to the ‘direct costs’ of a credible option in the RIT-T was a deliberate, earlier change by the AER, to clarify that the costs of an option do not include the total costs of an option to all NEM participants.³ EnerNOC has confirmed that the costs in question are required to make DSM available. They are therefore the ‘direct costs’ that would be paid under a DM contract by ElectraNet.

The AER has previously provided specific guidance that it is appropriate to adopt the quoted contract costs in determining the costs of non-network options⁴. This approach mirrors that used for estimating other costs such as grid support payments to generators or procuring network options.

AEMO and ElectraNet consider that it would be incorrect to assume that all the money paid by EnerNOC to participating consumers is a wealth transfer. Presuming a competitive market for DM services, the amount paid to DM providers should reflect their direct costs, including costs passed on to participating consumers, and a reasonable economic profit. DM participants are paid, among other things, to cover the costs of implementing systems and processes to provide demand response. Even if contract costs do include an amount above a reasonable economic profit, in reality it would be difficult to differentiate between contract costs and the underlying economic costs.

EnerNOC’s PSCR submission⁵ also suggests that payments to customers participating in a DM program should be considered as a market benefit. ElectraNet and AEMO note that DM payments to customers would not fall under any of the RIT-T market benefit categories set out in the NER. We also do not consider that DM availability payments would constitute a

¹ AER. Final Regulatory investment test for transmission application guidelines. June 2010. Pg12.

² NER. 5.16.1(8)(i).

³ AER, Regulatory Test Version 3, Final Decision, November 2007, p. 31-32.

⁴ AER. Regulatory Test Version 3, Final Decision, November 2007, pg 35.

⁵ EnerNOC, 30 January 2012, pg 5. Available at:

http://www.aemo.com.au/Electricity/Planning/Regulatory-Investment-Tests-for-Transmission-RITTs/~/_media/Files/Other/planning/0179-0305.pdf.ashx.

relevant additional category of market benefit for a RIT-T assessment. In the same way, availability payments to generators to provide network support are not included as a benefit to generators in the RIT-T assessment, but are instead treated as part of the cost of such options.

ElectraNet and AEMO consider that the RIT-T principles and guidelines regarding the treatment of costs for this option have been followed. EnerNOC has raised a point which may warrant further consideration by the AER in relation to the guidance provided on assessing the costs of non-network options in RIT-T assessments generally.

However, it is clear that the current RIT-T provisions and existing AER guidance support the approach adopted for this RIT-T.

The differential between Victorian and South Australian gas prices

The NGF raised concerns over the differential between Victorian and South Australian gas prices in its letter to the AER. AEMO and ElectraNet have used the latest information derived from ACIL Tasman consultants that had been consulted on publicly with industry and was available at the time the modelling was conducted. The PACR included several sections addressing the position taken and why, including:

- A section addressing the treatment of uncertainty⁶, which includes the inclusion of a number of scenarios using different gas price assumptions⁷. The RIT-T results are robust across these scenarios.
- A section on the cost of gas generation exported into South Australia⁸, which included an invitation for further sharing of fuel costs to improve modelling outcomes via the AEMO Planning consultation process. AEMO advises that, at the time of writing, no submissions have been received offering updated fuel cost information to be used in future modelling.
- A section in the appendix⁹ detailing the varying gas prices used in the reasonable scenarios modelled.

The NGF did not query the assumption about relative gas prices in either its PSCR or PADR submissions. Nor has the NGF chosen to dispute the application of the RIT-T by the proponents. The NGF notes: “gas prices in Victoria have been historically lower than South Australia”, which is consistent with the published gas prices¹⁰ on the AEMO website that were input into the modelling.

⁶ PACR, Section 4.2, Finalisation of the PACR in light of uncertainty, pg 45.

⁷ Further information on the gas price differences is included in section 5.4 of the PACR, Description of reasonable scenarios.

⁸ PACR, pg 64.

⁹ PACR, Appendix C, Section C.4, pg 130.

¹⁰ AEMO. Available at: http://www.aemo.com.au/Electricity/Planning/Related-Information/~/_media/Files/Other/planning/ACIL_Tasman_Wholesale_Fuel_Cost_Projections%20xls.xshx.

Related network investment not costed in the modelling

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

1. A new Ballarat-Moorabool 220 kV line upgrade occurs in 2016/17.
2. The existing Ballarat-Bendigo 220 kV line is uprated in 2016/17.
3. New 275 kV supply to Riverland area in South Australia in 2025/26.

AEMO and ElectraNet met with the NGF, advising them that these upgrades were included in the base case, or 'do nothing' option in addition to any credible (upgrade) options considered. As a result, any benefits from these upgraded elements will be effectively excluded from the net benefits of the interconnector upgrade since they are also in the base case (i.e., they cancel each other out).

These network augmentations have been included due to triggers that are distinct and in no way related, to the Heywood Interconnector Upgrade. The likely relocation of gas plant or any other plant that is reported on in the PADR and PACR is as a result of the Heywood augmentations alone.

AEMO has released a PADR for items one and two above on 22 March 2013, which shows net positive benefits for these network developments.

The Riverland network development does not increase the capability across the Murraylink interconnector above the current 220 MW limits. The requirement for this augmentation is expected for reliability corrective action. There is no reason to believe that inclusion of this project would either artificially create benefits or bias the results towards any of the credible options considered.

Improved demand forecasts and updated carbon price modelling

Both the NGF and Macquarie Generation have raised concerns over the scenarios modelled, in particular, raising the possibility of lower demand forecasts and carbon prices in the future compared to those modelled¹¹. Sections 4.2 and 4.4 of the PACR present ElectraNet and AEMO's view in relation to the changing environment, including the consideration of demand forecast and carbon price concerns in relation to the reasonable scenarios studied. Of note:

- ElectraNet and AEMO adopted a fourth scenario in the PACR in response to what became an apparent shift in consumption patterns and the potential for a lower carbon price after the release of the 2012 NEFR, as well as submissions from stakeholders on the PADR.
- The revised central scenario models both the lower 2012 National Electricity Forecasting Report (NEFR) demand forecasts, and assumes a low carbon price, with the results showing that Option 1b provides substantial market benefits and is the highest ranked option under this scenario.
- When the assumed carbon price is plotted against the net market benefits from the RIT-T analysis, there is no linear relationship between the assumed carbon price and the estimated net market benefits of Option 1b. Further, a generation dispatch benefit

¹¹ Note that the NGF's submission to the PSCR did not query the expected demand or carbon price forecasts.

would still be expected to be present under lower carbon prices as a result of the augmentation.

A sensitivity increasing the weighting of this scenario has also been included in Section 6.3.2 of the PACR.

The NGF states that 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', and comments that there is no evidence that the recent history of declining demand will plateau and recover.

As discussed in the PACR, the modified central scenario does not assume a recovery in demand and shows substantial market benefits. It is therefore not the case that the RIT-T relies on an assumption of a recovery in demand. The NGF also notes that it has witnessed further declines in demand in Victoria and South Australia in the year to date, and suggests delaying a decision on the RIT-T until more reliable demand forecasts are available.

AEMO and ElectraNet note that the recently published 2012 ESOO Update¹² provides an analysis of the 2012 NEFR forecast accuracy, showing a 1.1% variance between the forecast and actual operational demand across the NEM. This result indicates that there is no evidence of expected further falls in demand compared with the 2012 NEFR, based on information currently available, so there is no reason to defer a decision until new demand forecasts are available.

¹² AEMO, 22 Feb 2013. Available at:
http://www.aemo.com.au/Electricity/Planning/~/_media/Files/Other/planning/esoo/2012/2012_ESOO_Update.ashx.