HSBC Building
Level 19
580 George Street
Sydney NSW 2000
PO Box R41
Royal Exchange NSW 1225

Phone 61 2 9693 0000
Fax 61 2 9693 0093
www.apa.com.au

APA Group

Australian Pipeline Ltd
ACN 091 344 704

Australian Pipeline Trust
ARSN 091 678 778

APT Investment Trust
ARSN 115 585 441

09 April 2012

Mr Philip Weickhardt
President, Electricity Network Inquiry
The Productivity Commission
GPO Box 1428
Canberra City ACT 2601
By email: electricity@pc.gov.au

Dear Mr Weickhardt

Issues Paper – Electricity Network Regulation

The APA Group welcomes this opportunity to respond to the Productivity Commission's (Commission) inquiry on Electricity Network Regulation.

The APA Group owns and manages a diverse portfolio of energy infrastructure assets across Australia, with a value of approximately $9 billion. These assets include two interstate electricity interconnectors which operate in the National Electricity Market.

APA therefore has a keen interest in ensuring that the electricity regulatory regime delivers outcomes that not only foster efficient new investment in energy infrastructure, but safeguard the business interests of existing investors in energy assets.

APA's comments address two of the issues covered by the Commission's paper.

Benchmarking

It is important to keep in mind that any change to the regulatory framework affects both existing and future investors and should not be done lightly.

The existing regulatory framework provides for a regulated rate of return reflecting the relatively low-risk nature of electricity transmission investments. Network investments are not rewarded with speculative rates of return; returns are based on the recovery of costs over the service life of the asset. Potential investors will need assurance that this principle will remain the case before making commitments.

In particular, it is critical that any benchmarking approach recognises the investment that has been made under historical regulatory regimes, under which that investment has been found to be prudent and efficient.

The benchmarking of electricity businesses' productivity (and TFP benchmarking in particular) almost always uses energy delivered as the output measure, simply because it is

able to be readily measured[1]. This is highly problematic, as energy delivery (and hence apparent network productivity) is responsive to price changes for reasons such as the carbon tax and fuel prices. Moreover, network investment for growth and renewals takes place in cycles and when this is high, the apparent productivity is low. Given too much credence, benchmarking has the potential to deliver inappropriate pricing outcomes and investment signals.

In the case of 'single' electricity transmission assets such as Murraylink and Directlink, benchmarking is not an appropriate way to establish the price or revenue path. Their 'output' is the continued availability of full interconnection capability to meet the requirements of the electricity market to reduce the overall cost of supply. These assets are unique and have no logical comparators on which benchmarking could be based. Rather, the existing cost build up approach needs to be retained and supplemented, as at present, with an availability incentive.

Overall, the benchmarking of certain performance outcomes is useful only as an adjunct to the establishment of revenues using the existing cost build-up approach. The fundamental objective enshrined in the National Electricity Law will not be achieved with regulatory uncertainty, which will ultimately deter investment[2].

Interconnections

APA's experience with the development and operation of electricity interconnections leads it to believe that enhancement of the existing regulatory framework is required, to optimise the use of existing infrastructure and ensure the economic development of expanded interconnector capacity.

Interconnector capability is not always delivered through investment in headline-grabbing, big-ticket, high capacity projects. Incremental investment can also provide useful economic benefits. In the case of Murraylink, the capability to provide enhanced interconnection and local transmission capability was identified nearly a decade ago. This is available at modest cost from the development of 'smarter' control systems and the use of its voltage compensation capacity. However, the existing regulatory framework does not provide any participant with an incentive to develop these initiatives. AEMO's submission to AEMC on the Transmission Frameworks Review highlighted this issue[3].

By its nature, any new interconnection has scope to effectively bypass existing interconnections, and will to some extent reduce the utilisation of existing assets and their value to the market. However, the regulatory framework encouraged investment in the

---

1 IPART, Review of the Productivity Performance of State Owned Corporations - Other Industries — Final Report, July 2010, p.51.

2 The National Electricity Objective is "... to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity ...".

3 AEMO, Submission to Transmission Framework Review First Interim Report, 20 February 2012, p. 13.

existing assets on the basis of a low-risk return over the full life of the asset, and needs to preserve that return over the full life of the assets.

APA is concerned that the existing regulatory arrangements encourage investment by the existing TNSPs in large-scale interconnection projects that extend their own systems. The RIT-T seeks to ensure that the market benefits will exceed the cost of the investment. However, the RIT-T does not necessarily encourage the development of innovative solutions or the comparison of a broad range of feasible solutions.

A case in point is the current investigation of increased interconnection capacity between Victoria and South Australia, where most options under consideration are large scale, high capacity AC or DC interconnections[4]. The development of a second DC light interconnection similar to Murraylink (technology with which none of the other TNSPs have experience) would, prima facie, provide lower cost interconnection capacity and at the same time resolve capacity constraints in the remote regional transmission networks.

Moreover, the range of feasible solutions tested by the RIT-T as currently structured does not acknowledge the shift from coal-fired to gas-fired generation in the infrastructure solution. APA considers that, for many reasons, it is more likely that the efficient solution to Australia's electricity needs will be in gas infrastructure rather than electricity transmission.

APA considers that the shift from coal-fired to gas-fired electricity generation requires a re-think of the role of the electricity network planning process in a market environment, ensuring recovery of investment in gas or electricity transmission infrastructure to serve the generation sector.

Yours sincerely

Peter Bolding
General Manager
Regulatory and Strategy

[4] ElectraNet-AEMO, Joint Feasibility Study - South Australian Interconnector Feasibility Study Network Modelling Report, February 2011, p. 12.