

Australian Energy Market Commission

Draft Rule Determination

**National Electricity Amendment (Process for
Region Change) Rule 2007**

Rule Proponents
Names

27 September 2007

Signed:


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Chairman

For and on behalf of
Australian Energy Market Commission

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About the AEMC

The Council of Australian Governments, through its Ministerial Council on energy, established the Australian Energy Market Commission (AEMC) in July 2005 to be the Rule maker for national energy markets. The AEMC is currently responsible for Rules and policy advice covering the National Electricity Market. It is a statutory authority. Our key responsibilities are to consider Rule change proposals, conduct energy market reviews and provide policy advice to the Ministerial Council as requested, or on AEMC initiative.

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Summary

The National Electricity Market (NEM) is a regional market. A spot price for wholesale electricity is set separately for each region for each half-hour trading interval. There are currently six regions: Queensland, New South Wales, Snowy, Victoria, South Australia and Tasmania. The National Electricity Rules (Rules) provide for changes to the boundaries of these regions in rule 3.5, although since the NEM commenced in 1998, the regions have not changed. In fact, the recent Australian Energy Market Commission (AEMC or Commission) decision to abolish the Snowy region from 1 July 2008 will be the first such region change.

In October 2005, the Ministerial Council on Energy (MCE) submitted a Rule change proposal to reform the criteria and process for region change in the NEM. The MCE proposed to replace the current technically-based criteria and review process in the Rules with an application initiated process and forward looking economically-based market criteria, which must be satisfied before a region change can be made by the Commission. In considering this Rule proposal on the process for region change, the Commission has consulted with stakeholders and has had regard to the procedural and analytical experience it has gained through the related Rule change proposals involving the review of the Snowy region boundaries. The Commission has also ensured consistency between this draft Rule and the draft findings of its more general review of congestion management in the NEM.

The MCE's proposal seeks to implement the key policy principles set out in its May 2005 Statement on NEM Transmission. In that Statement, the MCE stated the importance of stability and predictability in a region structure, with changes to regions only occurring if they provide a net improvement to the efficient operation and investment environment of the market. The Commission agrees that these key principles provide an important framework that promotes region change as a means for addressing transmission congestion only when it is enduring and material and when there is a clear economic case for the change. This, in turn, can promote efficient investment options in transmission, generation and load to address congestion in the stages prior to considering a region change.

The draft Rule reflects the original policy framework contained in the MCE's Rule proposal. In addition, the Commission has incorporated into the process and implementation of a region change the key lessons from the assessment of the various Snowy region related Rule change proposals and the implementation of the abolition of the Snowy region. The Commission has assessed the draft Rule against the statutory Rule making test and the NEM Objective and concludes that the draft Rule satisfies the statutory Rule making test and is likely to promote the NEM Objective. This draft Rule determination presents the Commission's analysis in support of its decision, and sets out how the Commission has modified the Rule proposed by the MCE in the light of the Commission's more recent experience.

One example of a refinement added by the Commission is the inclusion of a preliminary consultation stage prior to formally accepting a region change application. This stage provides an opportunity for interested stakeholders to provide comment on the region change application and for the Commission to take into account those comments in deciding whether the application should go forward.

In assessing the Snowy region proposals, the Commission learned that it is not possible to analytically assess how a region change will affect the efficiency of dispatch and trading in the market without undertaking quantitative modelling, which requires the network constraint equations that would be used by the National Electricity Market Management Company (NEMMCO) dispatch engine if the proposal was adopted. The Commission understands the time consuming and costly process for deriving such network constraint equations and therefore has included an initial consultation period for stakeholders to evaluate whether there is merit in further investigating the proposed technically competent region change application.

The Commission views this draft Rule as an important component part of the regime for managing congestion in the NEM. An efficient and robust process for assessing and implementing region change will support the efficient evolution of the market over time. The Commission agrees with the MCE that region change should only occur in circumstances where there is material and enduring transmission congestion and where there is a clear case that region change will improve the economic efficiency of the market. The Commission considers that the proposed criteria and process for consideration of applications for region change set out in the draft Rule and described in more detail below, represents an efficient and robust process for region change in the NEM.

Criteria for region change

The MCE considered that the criteria for assessing a region change should be forward looking and economically based. A net improvement to the efficiency of dispatch was considered a reasonable basis for the revised criteria. The MCE also considered that there should be an economic benefit threshold, such as [\$xxx] or [x%] of the gross value of energy traded in the market.

In light of its experience considering the Snowy region related proposals, the Commission has elaborated on and refined the MCE's proposed criteria. The criteria set out in the draft Rule require the Commission to be satisfied that the region change solution will materially improve economic efficiency, which includes but is not limited to, improvements in productive efficiency, efficiency in relation to the management of risk and the facilitation of forward contracting, and long term dynamic efficiency. The region change must also be an appropriate and timely course of action in all circumstances, having regard to the alternative congestion management options and must be consistent with power system security and reliability. Finally, where the period for implementing the region change is proposed to be greater than or less than the standard three years, the person proposing that implementation period must explain why it should be different.

Accepting a region change application

The process for region change in the draft Rule commences with an application, which may only be made by NEMMCO or a Registered Participant¹. A key component of the MCE proposal was for applicants to be required to provide a substantive case in support of their application, as a means of deterring misconceived applications. The Commission has given effect to this policy intent by introducing into the draft Rule a formal step at the start of the process. This requires an application from either a Registered Participant or NEMMCO to be “complete”. A complete application must:

- Demonstrate the presence of a material and enduring congestion problem;
- Present a technically competent proposal for region change (with information from NEMMCO if required);
- Provide a preliminary case that the region change will or is likely to materially improve the economic efficiency of the market; and
- Present a case that supports a region change as the procedurally appropriate and timely response, given the alternative means of managing congestion.

Once the Commission has received an application that complies with the requirements set out in the draft Rule, it will undertake a preliminary consultation of 21 business days. This early consultation provides stakeholders with the opportunity to make submissions at an early stage on whether the region change application should proceed through a full process for region change. Once the Commission accepts an application and commences first round consultation, an applicant is unable to withdraw the region change application.

Having taken account of any comments from this preliminary consultation, the Commission must determine whether or not to accept the region change application. If the Commission considers that it should not proceed, it may make a decision to not accept the application and publish its reasons for its decision. If it is satisfied that the application is complete the Commission will make a decision to accept the region change application and commence first round consultation.

First round consultation

The first round consultation stage (75 business days) is a critical stage of the region change process set out in the draft Rule. At this stage and only at this stage, other parties can propose alternative region solutions that seek to address the same material and enduring congestion problem identified by the applicant. These

¹ A *Registered Participant* is “a person who is registered by NEMMCO in any one or more of the categories listed in clauses 2.2 to 2.7 (in the case of a person who is registered by NEMMCO as a *Trader*, such a person is only a *Registered Participant* for the purposes referred to in clause 2.5A). However, as set out in clause 8.2.1(a1), for the purposes of some provisions of clause 8.2 only, NEMMCO and *Connection Applicants* who are not otherwise *Registered Participants* are also deemed to be *Registered Participants*.” National Electricity Rules version 16, Chapter 10, Glossary.

alternative region solutions must meet the same initial criteria as the region change application in relation to an alternative region solution.

Also at this stage, the Commission may direct the applicant, or a person putting forward an alternative region solution in a submission, to provide supplementary economic analysis (which may include economic modelling). The draft Rule empowers the Commission to direct NEMMCO to provide information, e.g. constraint equations orientated to the proposed region change, to support the preparation of this supplementary economic analysis.

Draft region determination and second round consultation

The Commission's draft region determination will consider the region change application and any accepted alternatives against the "base case" of the continuation of the then prevailing regions, and against each other. It will be guided by the economic criteria specified in the draft Rule as well as the NEM Objective. This process enables the Commission to consider all alternatives together and adopt a region change solution that is the best available solution to an identified congestion problem. The draft Rule requires the Commission to publish its draft region determination within 60 business days of the end of first round consultation. Second round consultation on the draft region determination is also 60 business days.

Final region determination and implementation

After considering any submissions from second round consultation, the final stage of the region change process is for the Commission to issue a final region determination within 40 business days of the end of the second round consultation.

Regarding implementation of a region change, NEMMCO must prepare and publish a "Region Change Implementation Procedure" on the recommended region change option as presented in the draft region determination no later than the close of second round consultation. This provides stakeholders an opportunity to consider implementation issues associated with a region change option before the decision is finalised. The default lead time for implementing a region change will be three years after the final region determination is issued. The Commission is seeking views on whether provisions should be made for an expedited implementation, if there is broad support among market participants.

The MCE proposal recommended consultation with jurisdictions that may be affected by a region change prior to issuing a final region determination. The Commission agrees that consultation with jurisdictions that may be affected by a region change is appropriate and the draft Rule requires the Commission to do so.

The MCE proposal also recommended that the Commission have a role to undertake an ex post review of the impacts of an implemented region change. The Commission considers that such a review would arguably introduce an unnecessary degree of regulatory risk to the overall region change process. It does not consider that there is a role for such a review as part of the region change process, and has accordingly not included such a provision in the draft Rule. The Commission is seeking views from stakeholders on the value or otherwise of having an ex post review function.

The Commission notes that the specified consultation and assessment timetables for the region change process are longer than the standard timetables for a Rule change given the complexity of the issues under consideration. The draft Rule also provides the Commission with the flexibility to extend timetables if required.

In light of this draft Rule determination and the level of prescription in the draft Rule, the Commission is also seeking views from stakeholders on whether there is a need for, and the scope of, detailed guidelines for region change applications, which would elaborate on the procedural requirements for applicants and other stakeholders who wish to engage in the region change process.

The Commission invites interested stakeholders to make comments on the issues raised in this draft Rule determination and the draft Rule. Under s.101 of the National Electricity Law, any interested person or body seeking a hearing on this draft Rule determination must send their request in writing to the Commission no later than 5 October 2007.

Submissions should be received by 9 November 2007. Submissions can be sent electronically to submissions@aemc.gov.au or by mail to:

Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

1 The Rule change proposal

On 5 October 2005, the Chairman of the Ministerial Council on Energy (MCE), the Hon Ian Macfarlane MP, submitted a Rule change proposal on behalf of the MCE to reform the criteria and process for region change in the National Electricity Market (NEM).

1.1 An Overview of the policy context for the proposed Rule change

Regions perform a critical role in the NEM design. According to the MCE proposal, their purpose:

“is to allow market prices to reflect the effect of significant ‘pinch-points’ that lead to congestion in the transmission network ... Regional boundaries facilitate the price rationing of transmission resources where generation and demand patterns require more capacity than is available from the transmission system.”²

Region boundaries are intended to transparently identify physical points of material and enduring congestion, so that market participants can more efficiently manage the risks associated with inter-regional trade. Price separation between regions, which occurs when key transmission flow paths become congested, can also provide a locational signal for efficient new generation investment and load.

There are currently six regions within the NEM. The New South Wales, Victorian, Queensland, South Australian and Snowy regions were established at market start in December 1998. The Tasmanian region was added when Tasmania joined the NEM in 2005. These regions have remained unchanged since their establishment. The Commission’s final Rule determination³ and Rule⁴ to abolish the Snowy, with effect from 1 July 2008, is the first change to an existing region since market start.

The initial regions are largely based on jurisdictional boundaries at NEM commencement. This reflected the state-based nature of power system development prior to market start, with regional power systems independently developed by electricity utilities serving each State and Territory. As a consequence, interconnection was typically weak, or non-existent, at jurisdictional boundaries. This made the boundaries between jurisdictional transmission systems a logical place to establish the initial set of NEM region boundaries.

Ideally, regions should be areas within the power system that are free of material congestion. In practice, the trade-offs made between the granularity of the regional structure and transaction costs mean that some degree of congestion is likely to remain.

² Ministerial Council on Energy (MCE), *National Electricity Rules – Rule Change Request Reform of Regional Boundaries*, Rule change proposal, 5 October 2005, p.3. (MCE Rule change proposal)

³ AEMC 2007, *Abolition of Snowy Region*, Final Rule Determination, 30 August 2007, Sydney.

⁴ National Electricity Amendment (Abolition of Snowy Region) Rule 2007 No. 7.

Regional market designs, such as the NEM, do not seek to identify all points of congestion nor do they seek to dynamically adjust for transitory changes in the location of congestion. They seek to strike a balance between the granularity of the regional structure and the likely transaction costs associated with trading across many region boundaries, with a view to maximise incentives for efficient operational and investment behaviour at least cost. Their purpose is to identify physical “choke” points of material and enduring congestion.

The inherent volatility associated with wholesale power flows implies that most points of congestion are unlikely to be both material and enduring. However, power systems are dynamic, with changes to underlying flows resulting from growth and development of the system possibly leading to the emergence of new points of material and enduring congestion over time.

The NEM market design recognises these practical realities and incorporates a process to trigger region change, to ensure that regions evolve to reflect points of material and enduring congestion across the integrated NEM.

The current rules governing the evolution of region change, reflected in rule 3.5, largely rely on a technical trigger and technical assessment criteria to determine the merits of a potential change. The trigger conditions and criteria were established to facilitate a relatively dynamic approach to region change as a primary response to address material congestion, which was not addressed within a relatively short period by operational or investment responses. The current rules do not incorporate economic criteria into the assessment process.

Policymakers have noted the fundamental uncertainties, arbitrary nature, and potentially high transaction costs associated with this relatively dynamic approach to managing changes to the regional structure. The MCE proposal seeks to introduce a more stable and efficient evolution of NEM regions and region boundaries with the least disruption and cost to the market; this approach is consistent with its incremental approach to congestion management.

Policymakers have placed a moratorium on the current region change process pending the outcome of this Rule change proposal through clause 3.5.4.

1.1.1 Policy principles governing region change

In December 2003, the MCE submitted a report to the Council of Australian Government detailing its proposed policy response to the Parer Report.⁵ The MCE report included a package of electricity transmission reforms to establish, among other things, a new and more transparent process for the assessment of region changes for the NEM. The expectation was that these reforms would facilitate more efficient investment and operational responses.⁶

⁵ Council of Australian Governments Energy Market Review, *Towards a Truly National and Efficient Energy Market*, Final Report, December 2002.

⁶ MCE Rule change proposal, p.1.

In May 2005, the MCE issued a Statement on NEM Electricity Transmission, which further clarified the key policy principles governing its approach to region change. Key conclusions relating to region change included:

- **“Regional Structure** - The regional structure for the wholesale market should be stable, based on current boundaries and with robust economic criteria to support incremental change as required. MCE accepts [Charles River Associates’ (CRA’s)] advice that no material efficiency benefits would be gained from a nodal pricing approach at this stage of market development.
- **Frequency of Boundary Change** - The existing process of annual boundary reviews will cease. Two alternative options will be considered by the MCE: periodic reviews with a longer interval between reviews (eg. the 5-yearly cycle recommended by CRA); or boundary change assessment by application (eg. participants would apply to the AEMC for a review of regional boundaries under the formal regional boundary Rule change process). The MCE supports giving advanced notice of a boundary change to allow registered participants the opportunity to adjust their contract trading positions and minimise their commercial risk.
- **Change Criteria** - Criteria to amend boundaries should be forward looking and economically based. A net improvement to the efficiency of dispatch is considered a reasonable basis for the revised criteria. The MCE will undertake further work to refine the thresholds which will trigger a change. This will be reflected in the Rule change to be initiated by the MCE. There will be consistency in the economic criteria used for assessing regional boundary changes and for assessing transmission investment.”⁷

These policy principles are reflected in the MCE’s Rule change proposal, which include the following:

- The region change process should support the maintenance of a relatively stable regional structure, based on existing regions;
- The process should be integrated into a comprehensive congestion management framework that allows for incremental responses to address material and persistent congestion;
- Within this framework, region change should be viewed as an appropriate long term response to address enduring “choke points” of material congestion in the absence of other economic responses, such as new investment. It is envisaged that region changes would be undertaken relatively infrequently;
- Proposed region changes should be assessed against forward-looking, economic criteria;

⁷ MCE, *Statement on NEM Electricity Transmission*, May 2005, p.4-5.

- Region changes should be implemented in a manner that minimises uncertainty and adjustment costs for market participants; and
- Potential region changes that may have consequences for retail pricing within a jurisdiction should be discussed with affected jurisdictions prior to publication of a final region determination.⁸

This incremental approach represents a departure from the previous policy paradigm which was based on more dynamic region changes to manage congestion, subject to deterministic region change criteria.

1.1.2 Related developments

This draft Rule determination has been developed contemporaneously with the Australian Energy Market Commission (AEMC or Commission) undertaking a Congestion Management Review (CMR) at the direction of the MCE. The Commission notes that Section 3.2 of the CMR Terms of Reference indicates that region boundary review criteria and review triggers should be considered in the context of formulating a comprehensive congestion management framework to manage material congestion issues until they are addressed through investment or a region change.

The Commission is conscious of the inter-relationship between this Rule change proposal and other work it is progressing on congestion management, in particular the CMR and the various Rule change proposals related to managing congestion in the Snowy region. In particular, the implementation of the abolition of the Snowy region has greatly informed the Commission's consideration of that aspect of this Rule change proposal.

Accordingly, the Commission's adopted approach has enabled it to consider these projects in parallel, with a view to developing a congestion management regime that is comprehensive, appropriately integrated and consistent with an incremental policy approach. The Commission's approach has been articulated in its June 2006 and December 2006 Statement of Approach documents, and most recently in the Congestion Management Review Work Program Update, which was foreshadowed in its March 2007 Congestion Management Review Directions Paper.⁹

The Commission has drawn from work undertaken in the context of preparing its CMR Draft Report and from its Snowy region related Rule change experience in formulating this draft Rule determination on process for region change.

⁸ MCE Rule change proposal, p.3.

⁹ See AEMC 2006, *Congestion Management Program - Statement of Approach*, 6 June 2006, Sydney; AEMC 2006, *Congestion Management Program - Statement of Approach December 2006*, 7 December 2006, Sydney; AEMC 2007, *Congestion Management Review Work Program Update*, 28 March 2007, Sydney; AEMC 2007, *Directions Paper, Congestion Management Review*, 12 March 2007, Sydney.

1.2 Overview of the MCE proposal

The Rule proposed by the MCE seeks to respecify the criteria and process for region change. Key features of the proposal include the following:

- Introducing new assessment criteria that move from a technically based assessment to an economic one;
- Introducing a new region change process, administered by the Commission. The proposal provides for a region change process initiated by an application from a registered participant or NEMMCO. The proposed process would incorporate greater transparency and more accountable decision-making against the NEM Objective, reflecting the Rule change process established in the National Electricity Law (NEL);
- Empowering the Commission to initiate a region change review to assess the economic merits of possible region boundary changes to address identified “choke points” of material and enduring congestion in the event that applications are not forthcoming. The Commission would be required to publicly report the findings of its review; and
- Empowering the Commission to undertake a post-implementation review of an implemented region change to assess whether the change was successful.

An outline of the key features of the proposed assessment criteria and region change process follow.

1.2.1 Region change and review assessment criteria proposed by MCE

The MCE proposal envisages that region change applications will be assessed against “application” criteria to determine whether they are to be accepted for evaluation, and subsequently assessed against “evaluation” criteria to determine whether the proposed region change will be implemented.

The proposed application criteria focus on the nature and quality of the application including:

- Eligible Applicant Test. The MCE proposal restricts eligible applicants to registered market participants and the National Electricity Market Management Company (NEMMCO) (proposed clause 3.5.2(a)).
- Five-year Moratorium. The Commission can reject an application seeking the same or substantially the same region change as previously one considered during the previous 5 years. The Commission can accept an application that would otherwise be rejected under this criterion where it can demonstrate that material changes have occurred (proposed clause 3.5.2(b)).
- Information Requirements. Applications must be substantial, providing a detailed description of the proposed region change, reasons for the proposed change, all relevant technical details and detailed analysis suggesting that the proposal would result in material and enduring net economic benefits to all who

produce, consume and transport electricity, consistent with the NEM Objective (proposed clause 3.5.2(d)). The Commission would be empowered to refuse to consider an application until the information requirements are met (proposed clause 3.5.2(e)).

- Misconceived or Lacking in Substance. The Commission can refuse to consider an application it considers to be misleading or lacking in substance, particularly where it is considered to be designed to discourage investment proposals (proposed clause 3.5.2(f)).

Proposed “evaluation” criteria focus on the extent to which the proposal would maximise net economic benefits, consistent with the NEM Objective, including:

- Economic Benefits Test. The Commission should base its determination on whether the proposed region change is likely to result in a material and enduring net economic benefit to all who produce, consume and transport electricity (proposed clause 3.5.2(c)). The MCE proposes that a net improvement in dispatch efficiency greater than a pre-determined threshold value would be a reasonable basis on which to make the assessment. The MCE also suggests that the evaluation be based on a forward-looking assessment of the net economic benefits.¹⁰
- Transparent and Consistent Application of the Process. The Commission on must also have regard to the transparent and consistent application of the process across the market (proposed clause 3.5.2(c)(1)).
- Alternative Mechanisms Test. The Commission must consider the extent to which alternative mechanisms provided for in the Rules, or an alternative region proposal, may achieve greater benefits (proposed clause 3.5.2(c)(2)).

Proposed criteria governing the Commission’s decision to initiate a review of possible region changes focus on materiality and the likelihood of an investment response. Under the proposal, the Commission would be empowered to initiate a review of possible region changes where:

- Materiality of Congestion. A constraint has been identified on a national transmission flowpath in the Annual National Transmission Statement (ANTS) that the Commission considers material and enduring (proposed clause 3.5.2(p)(1)).
- Investment Response. The Commission considers that it is unlikely that an investment proposal will relieve the constraint within two years (proposed clause 3.5.2(p)(2)).
- 5 year Moratorium. The constraint has not been considered as part of a previous region boundary change application during the previous five years (proposed clause 3.5.2(p)(3)).

¹⁰ MCE Rule change proposal, p.6.

1.2.2 Region change process proposed by MCE

The region change process proposed by the MCE is comparable to the standard Rule change process established in the NEL, incorporating a two-stage public consultation process, application of a region change test, and a final decision on whether or not to make a region change. A schematic summary of the proposed process of region change by application is provided in Figure 1.1. Key features of the proposed region change process include:

- Application-Driven Process. The MCE proposes that a process to change a region boundary would only be triggered by applications from eligible parties.
- Public Consultation. The MCE envisages a two-stage public consultation process, where the Commission invites submissions on accepted proposals and on the draft region determination (proposed clauses 3.5.2(g) & (l)). Stakeholders could also propose alternative region options to achieve a similar region change during the first public consultation round (proposed clause 3.5.2(h)(2)). The proposal also requires the Commission to convene a public hearing on request during the first and second public consultation rounds (proposed clauses 3.5.2(h)(3)-(i) & 3.5.2(l)(2)-(m)).
- Statutory Process Timeframes. The MCE proposal incorporates more generous statutory timeframes than the standard Rule change process, reflecting the inherent complexities and sensitivities associated with region change, and the consequent need for additional time to undertake consultation, analysis and assessment. Statutory timeframes proposed for key elements of the assessment process include:
 - first round consultation period – 40 business days after publication of Notice of Proposed Region Boundary Change (proposed clause 3.5.2(h)(2));
 - publication of draft region determination – within 60 business days after close of the first round submission period (proposed clause 3.5.2(j));
 - second round consultation period – 40 business days after publication of the draft region determination (proposed clause 3.5.2(l)); and
 - final region determination – within 40 business days after close of the second round consultation period (proposed clause 3.5.2(n)).
- Overall, it is envisaged that the proposed process from Notice of Proposed Region Boundary Change to publication of a final region determination would take 180 business days.
- No Expedited Process Option. Unlike the standard Rule change process, which incorporates an expedited process for routine, non-controversial rule changes (s.96 of the NEL), the MCE proposal does not include an expedited assessment process. This reflects the inherent complexity and sensitivity associated with region boundary change.

- Three-year Minimum Implementation Period. The proposal incorporates a three-year implementation period following publication of the final region determination (proposed clause 3.5.2(p)).
- Review of Region Change. The MCE proposes that the Commission be empowered to initiate a review to determine whether a potential region change may meet the assessment criteria where certain threshold measures of congestion are met.¹¹
- Post-implementation Evaluation. The MCE also proposes that the Commission undertake an evaluation of a region change after its implementation to assess whether it was “successful”.¹² However, this post-implementation evaluation process is not addressed in the proposed Rule.

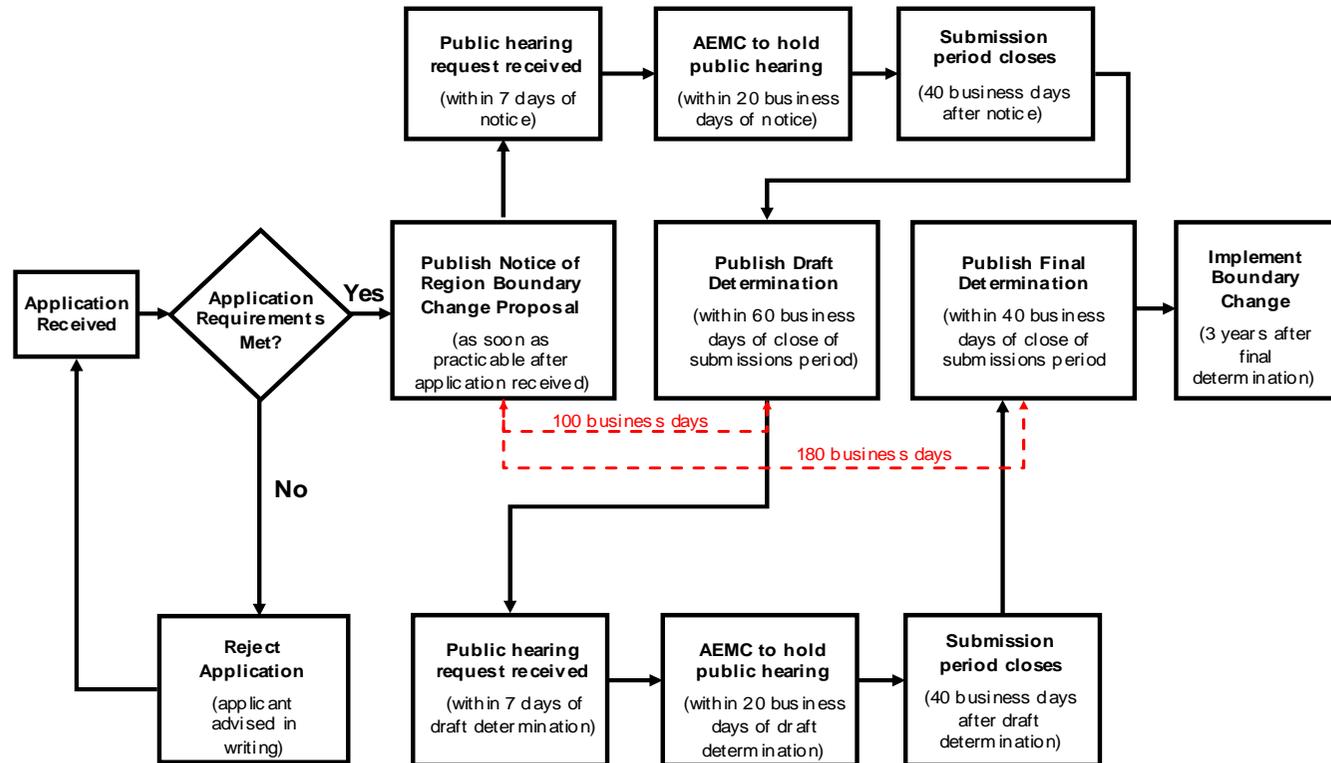
The MCE’s proposal also suggests that if a proposed region change may have implications for retail pricing within a jurisdiction that the Commission should consult with the relevant jurisdictions before publishing its final region determination.¹³

¹¹ MCE Rule change proposal, p.4-5, 7, 12.

¹² MCE Rule change proposal, p.6.

¹³ MCE Rule change proposal, p.7.

Figure 1.1 MCE region change proposal: process schematic



1.3 Problems identified with the current Rules

The current rules governing region boundary change envisage a relatively dynamic regional structure, with region boundaries reviewed annually and changed once the level of congestion exceeds a range of technical thresholds specified in the Rules.

The MCE proposal summarises the problems it identifies with the current rules governing region change, stating that:

“The boundary change process contained in the existing National Electricity Rules ... is technical and arbitrary, and does not necessarily provide the optimal boundary solution on an economic basis. The current boundary change process also provides inadequate guidance on the weighting of each criteria. There is therefore the potential for a region to be formed that would result in a negative net economic benefit for the NEM. The initial boundary change process also allowed boundaries to be reviewed and changed on a regular basis. This created unnecessary risk and uncertainty for industry resulting in an increased cost to business and reduced efficiency for the industry as a whole.”¹⁴

Accordingly, the proposal suggests that continuation of the current rules governing region change is unlikely to promote efficient market development, consistent with the NEM Objective.

When the initial Rules commenced on 1 July 2006, the MCE placed a moratorium on applying the existing rules governing region change until a revised criteria and process have been developed and implemented.

1.4 How the proposal seeks to address the identified problems

The MCE proposal seeks to address the identified problems by respecifying the assessment criteria and process for undertaking a region change. The proposed approach shifts the focus of the assessment from a technical to economic basis, consistent with the NEM Objective. It seeks to introduce a more transparent and accountable process for the Commission to administer.

This proposed market participant initiated application process would replace the current market institution based response, with its limited discretion to deterministic criteria. This has the potential to improve the efficiency and effectiveness of the process, while minimising the overall cost for market participants.

¹⁴ MCE Rule change proposal, p.3.

2 Draft Rule Determination

The Commission has determined in accordance with s.99 of the National Electricity Law to make the draft Rule attached to this draft Rule determination (Appendix A).

The draft Rule has sought to embody the key policy principles and intent of the original proposal, while reflecting the Commission's current legal drafting standards and practice, and incorporating the important lessons learned through the process of considering region boundary change (and other) proposals in respect of the Snowy region.

2.1 Commission's power to make the Rule

The MCE's proposal seeks to establish a new process and assessment criteria for amending NEM region boundaries.

The Commission is satisfied that the draft Rule addresses a matter for which it can make Rules, pursuant to section 34 of the NEL. Section 34 of the NEL empowers the Commission to make rules for regulating: the operation of the NEM; the operation of the national electricity system to ensure safe, secure and reliable system operation; and the activities of persons participating in the NEM or involved in its operation. The draft Rule specifically relates to the:

*"division of the national electricity market into regions for the purpose of the operation of the wholesale exchange operated and administered by NEMMCO."*¹⁵

The Commission is able to make a rule where it "is satisfied that the Rule will or is likely to contribute to the achievement of the national electricity market objective."¹⁶

The National Electricity Market objective seeks to promote:

*"efficient investment in, and efficient use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system."*¹⁷

This draft Rule determination sets out the Commission's reasons for making the draft Rule. In developing the draft Rule, the Commission has taken into account:

- The Commission's powers under the NEL to make the Rule;
- The proponent's Rule change proposal and proposed Rule;

¹⁵ See item 9, Schedule 1 to the National Electricity Law (NEL).

¹⁶ Section 88 of the NEL.

¹⁷ Section 7 of the NEL.

- Submissions received;
- Relevant MCE statements of policy principles; and
- The Commission's analysis as to the ways in which the draft Rule will, or is likely to, contribute to the achievement of the NEM Objective, such that it satisfies the statutory Rule making test.

The Commission has examined the draft Rule and assessed it against the statutory Rule making test. Section 3 presents the Commission's analysis of key issues raised by the MCE proposal. This analysis supports the Commission's conclusion that the draft Rule satisfies the statutory Rule making test.

2.2 Consultation on the MCE proposal

First round consultation pursuant to s.95 of the NEL commenced on 12 January 2006. The first round consultation period closed on 10 March 2006. The Commission received 13 submissions from:

- NEMMCO;
- The Australian Energy Regulator (AER);
- CS Energy;
- Delta Electricity;
- Hydro Tasmania;
- The National Generators Forum (NGF);
- Origin Energy;
- Powerlink Queensland;
- Snowy Hydro Limited;
- TransGrid;
- The Energy Retailers Association of Australia (ERAA);
- Ergon Energy; and
- TRUenergy.

These submissions are all available on the Commission's website.

In accordance with s.107 of the NEL, the Commission has extended the publication date of this draft Rule determination on this MCE proposal several times. On 4 May 2006, the Commission issued a s.107 notice, extending the period of time for it to publish a draft Rule determination to 30 November 2006. On 9 November 2006, the Commission published a second s.107 notice extending the publication date to

14 December 2006. On 14 December 2006, a third s.107 notice extended the publication date of the draft Rule determination to 28 June 2007. On 10 May 2007, the Commission published a fourth s.107 notice extending the publication date of the draft Rule determination to 30 August 2007. On 30 August 2007, the Commission published a fifth s.107 notice to extend the publication date to 20 September 2007. On 20 September 2007, the Commission published one additional s.107 notice to extend the publication date to 27 September 2007, aligning the release of this draft Rule determination with the CMR Draft Report.

These publication extensions were consistent with revised publication timeframes published in the Commission's June 2006 and December 2006 Congestion Management Program – Statement of Approach documents, and most recently in the CMR Work Program Update of 28 March 2007, which was foreshadowed in the March 2007 CMR Directions Paper.

From the outset, the Commission has recognised the inter-related nature of this process for region change proposal, the various Snowy region related Rule change proposals¹⁸, and the CMR. The Commission considered that it was in the public interest to align its consideration of these related projects so that they could be addressed in a comprehensive, integrated, and effective manner. The various extensions to the publication date of the MCE process for region change draft Rule determination were designed to allow its release to coincide with the evolving publication timeframe for the CMR Draft Report.

Coordinated development of these projects has allowed the Commission to develop an integrated approach toward congestion management, which is reflected in the refinements it has proposed in process for region change draft Rule. The Commission's views have been informed by the experience it has gained from evaluating the Snowy region related Rule change proposals and from the analytical work undertaken in the context of preparing the CMR Draft Report. The benefits of this approach are reflected in the draft Rule.

2.3 Assessment against the NEM Objective

The MCE proposal cites several ways in which the proposed Rule is expected to better meet the NEM Objective compared to the current rules governing region change.¹⁹

The MCE's incremental congestion management approach primarily relies on the creation of robust incentives promoting efficient investment responses to alleviate congestion. The proposal indicates that a predictable and stable framework for region change would help to encourage more efficient and timely investment

¹⁸ The Commission published its decisions on the three Rule change proposals related to managing congestion in the Snowy region on 30 August 2007. These included the final decision to accept the Abolition of Snowy Region Rule change proposal, and the two draft decisions to not accept the Split Snowy Region Rule change proposal and to not accept the Congestion Pricing and Negative Residue Management Arrangements for the Snowy Region Rule change proposal. These determinations are available on the Commission's website: www.aemc.gov.au.

¹⁹ MCE Rule change proposal, p.8.

responses to address material congestion by greatly reducing uncertainty over the role, function and likely implementation of region change. This would serve to encourage more efficiently timed and located new investments.

Under the draft Rule, new region boundaries would only be implemented where the net economic benefits for all who produce, consume and transport electricity were maximised, pursuant to the NEM Objective. This approach would be expected to produce superior outcomes compared to the existing rules governing region change.

The draft Rule will help ensure that any future new region boundaries would reflect “choke points” of material and enduring congestion, creating clear price incentives for the more efficient location of loads and use of electricity services.

More efficient operational and investment responses resulting from efficient evolution of region boundaries could be expected to deliver reliable, least cost electricity services, consistent with the longer term interests of consumers.

The process for region change set out in the draft Rule is more open and transparent than the current process, which allows for better informed, more robust and accountable decision-making than under the current Rules.

The Commission is satisfied that the draft Rule is likely to promote the NEM Objective. In reaching its conclusion, the Commission has taken account of the views expressed in submissions and analysis undertaken in the context of progressing related congestion management projects including the CMR and its assessment of the various Snowy region related Rule change proposals.

The Commission considers that application of the draft Rule will promote predictability, stability, and certainty in relation to future region boundary change, consistent with the policy principles underpinning an incremental congestion management approach and the clear stakeholder preference revealed in first round submissions. This should result in strengthening incentives for more efficiently timed and located investment over time. The Commission also considers that fundamentally changing the focus of a region change evaluation from a technical to an economic basis is more likely to result in region changes that maximise benefits under the NEM Objective.

The Commission also concludes that the reformed process for region change contained in the draft Rule will deliver greater efficiency, transparency, and accountability. Overall, the Commission considers that the draft Rule will promote efficient market development consistent with maximising outcomes under the NEM Objective. The Commission’s views are more fully discussed in Section 3 of this draft Rule determination. This analysis supports the Commission’s conclusion that the draft Rule satisfies the NEM Objective.

3 The Commission’s draft Rule: Structure and rationale

This Section explains the structure of the draft Rule that the Commission is proposing to make to give effect to the MCE proposal (Section 3.1). It then sets out the issues considered and reasoning behind the Commission’s adopted approach. For ease of exposition, the issues are discussed in the sequence that would be followed for a hypothetical region change application:

- Section 3.2 sets out how the regions are defined and by whom;
- Section 3.3 steps through the initial stage of the process, including preparation of a region change application;
- Section 3.4 discusses the aspects of first round consultation for an accepted application;
- Section 3.5 summarises the requirements to make a region determination;
- Section 3.6 identifies the process for preparing and consulting on a draft region determination;
- Section 3.7 discusses the process for preparing a final region determination;
- Section 3.8 summarises and explains the various consultation stages and timeframes; and
- Section 3.9 discusses the steps for implementing a region change in the NEM.

3.1 Structure and location of the draft Rule

For the purposes of consultation, the draft Rule has been presented as a separate Chapter (Chapter 2A). The Commission has decided not to present the draft Rule as an amendment to Chapter 3 of the Rules for easier understanding during consultation. A final Rule, when made, may be incorporated as an amendment to Chapter 2 or as a new Chapter. This will depend on the co-ordination of any other Rule changes at the time.

Part A of Chapter 2A of the draft Rule sets out the application process for region change. This includes elements such as eligibility criteria for applicants, what is required in an application, and what is the consultation process for a region change application. Part B of Chapter 2A of the draft Rule sets out the required steps to enable the efficient and effective implementation of a region determination made by the Commission.

3.2 Starting position

The draft Rule establishes that the AEMC shall determine the regions for the purpose of conducting the spot market, and that a region may only be changed pursuant to an application under the Process for Region Change draft Rule (clause 2A.1.2 of the

draft Rule). This represents a transfer in responsibility under the Rules from NEMMCO to the AEMC to both evaluate and determine region change proposals, consistent with the policy intent of the MCE proposal.

The draft Rule proposes that the AEMC defines the regions initially by reference to the existing NEMMCO Regions Publication (see definition of “old regions” in drafting note on page 17 of draft Rule). NEMMCO would continue to have responsibility under the Rules for maintaining and updating the Regions Publication periodically, e.g. to ensure that mapping of connection point to regions is kept up-to-date. The defining characteristics of each region could, however, not be changed by any means other than through a region determination by the AEMC under the new Chapter 2A process for region change.

Clarity on who is responsible for defining the regions, and precision on the scope of what is being defined, are important elements of a robust, transparent process for an application initiated region boundary change. The drafting note on page 17 of the draft Rule discusses the Commission’s definitional issues relating to regions. In particular, the Commission is seeking comment on what, specifically, is determined when it makes a region determination.

The Commission’s current view is that a region is defined at any point in time by:

- The Regional Reference Node (RRN);
- A mapping of connection points to a Region; and
- A list of region boundary metering points.

The Commission considers that if it determines these elements in its region determination, the mapping of connection points and the list of region boundary metering points could be updated by NEMMCO in its periodic Regions Publication to ensure continuing accuracy, e.g. to reflect new connection points, or the construction of new transmission circuits between two Regions, but could not be changed other than through a region determination by the AEMC (see clause 2A.1.2(b) of the draft Rule). The Commission welcomes views on the draft framework for defining regions, and for allowing NEMMCO to continue operational updating of region boundaries. The Commission also seeks views on the practical detail required for implementation of a region change.

3.3 Initiating a process for region change

This Section discusses the various aspects of the initial stage of the process for region change. Section 3.3.1 discusses the merits of an application-based approach over periodic review. Section 3.3.2 highlights how much of the Commission’s refinement of detail around the MCE proposal has been informed by its work on the Snowy region related Rule change proposals. Section 3.3.3 steps through the preparation of an application, defining further the specific requirements for a “complete application”. Section 3.3.4 discusses the process once the Commission determines whether an application is complete or not. Section 3.3.5 sets out how the Commission decides to accept or not accept an application for region change.

Section 3.3.6 comments on the Commission's views on publishing guidelines to assist stakeholders in preparing region change applications.

3.3.1 Application versus periodic review

The MCE proposal discusses initiating a region change process either by applications from Registered Participants²⁰ or NEMMCO or through a periodic assessment, possibly aligned with the five-year reset period for regulated transmission networks. The MCE concluded that an application initiated approach was more appropriate. Some stakeholders supported this conclusion, making the following key points:

- An application initiated process would avoid the uncertainty, risk, and undue regulatory costs associated with a periodic assessment process;²¹
- A periodic assessment process initiated by the Commission is likely to be unnecessary as commercial interests would bring forward a proponent for any region change that is likely to meet an economic benefits test;²²
- Registered Participants are best placed to identify whether a region change is needed since they face the costs and benefits of region change;²³ and
- The Commission does not currently have a market monitoring role.²⁴

These concerns echoed those in CRA's Final Report for the MCE on NEM transmission region boundary structure (CRA Final Report). This suggests that a region change process initiated by a regulatory body would be inconsistent with the notion of efficient market development being initiated by the independent decentralised decision-making of market participants.²⁵

However, the Commission also noted the views of stakeholders who supported a periodic assessment approach. The key arguments cited were:

- The current ANTS analysis provides an existing information source which could be used to trigger a review – which could be supplemented by an application-led approach, if required;²⁶

²⁰ A *Registered Participant* is "a person who is registered by NEMMCO in any one or more of the categories listed in clauses 2.2 to 2.7 (in the case of a person who is registered by NEMMCO as a *Trader*, such a person is only a *Registered Participant* for the purposes referred to in clause 2.5A). However, as set out in clause 8.2.1(a1), for the purposes of some provisions of clause 8.2 only, NEMMCO and *Connection Applicants* who are not otherwise *Registered Participants* are also deemed to be *Registered Participants*." National Electricity Rules version 16, Chapter 10, Glossary.

²¹ CS Energy, first round submission, MCE Rule change proposal, p.1.

²² CS Energy, first round submission, p.1.

²³ Origin Energy, first round submission, MCE Rule change proposal, p.2.

²⁴ Origin Energy, first round submission, p.3.

²⁵ Charles River Associates (CRA), *NEM – Transmission Region Boundary Structure*, Final Report, prepared for the Ministerial Council on Energy, May 2005, p.48.

²⁶ Delta Electricity, first round submission, MCE Rule change proposal, p.2-3.

- The current ANTS could be extended to include a forward-looking economic assessment based on materiality threshold triggers – which could then prompt further assessment by the Commission;²⁷
- Periodic review would avoid the Commission having to handle frivolous applications;²⁸ and
- An application initiated approach:
 - requires resources that are not currently available;
 - disadvantages smaller market participants;
 - encourages misconceived behaviour – and imposes costs on other participants in responding to perceived misconceived behaviour; and
 - increases uncertainty and mitigates against co-ordinated decision-making.²⁹

The Commission agrees with the MCE that a case can be made for adopting either approach, but that, on balance, the case for an application initiated approach is stronger. Periodic assessment may be procedurally more predictable, but might fail to address material congestion in a timely manner. It might also result in the imposition of an unnecessary additional layer of cost and risk if there is no economic case for changing the regions when the periodic review is due. While more frequent periodic review would address the former, it would potentially exacerbate the costs and risks associated with the latter.

Similar problems apply to the MCE’s proposal that the Commission should be able to initiate a region change review if it has not received an application for an identified material and enduring congestion point. In addition, the Commission considers that the market perceptions of regulatory risk would be greatly magnified if the Commission were empowered to initiate a periodic review process. It could create the perception of an inherent conflict of interest where the Commission recommended a region change, as part of a review, which later is incorporated into a region change application to be determined by the Commission.

For example, if the Commission conducted such a review it may include a recommendation for a proposed region change. If a Registered Participant put forward a region change application with that very proposed region change, then the Commission would have to make a region determination on the very region change it recommended in its periodic review, promulgating the perception of an inherent conflict of interest.

An application initiated process would provide a more flexible and market-based mechanism for initiating region change. It would also substantially remove any

²⁷ TRUenergy, first round submission, MCE Rule change proposal, p.3.

²⁸ Energy Retailers Association of Australia (ERAA), first round submission, MCE Rule change proposal, p.2.

²⁹ ERAA, first round submission, p.2-3.

perceptions of the Commission having any conflict of interests when it decides on region changes. Reliance on market participants to propose region change is more likely to ensure that meritorious options are identified and examined at an appropriate time, promoting efficient evolution of region boundaries. It is also likely to minimise overall compliance and regulatory costs compared to periodic assessment.

However, the Commission notes that in other contexts (e.g. the Last Report Planning Power, LRPP) the Rules provide for a 'safety net', if anticipated responses do not emerge. The Commission would welcome further views from stakeholders on whether such a safety net provision is appropriate in the context of an application initiated region change process, given the issues raised above. Submissions would be particularly welcomed on how the power to initiate a review might be limited in order to reduce perceptions of regulatory risk, and to ensure that market participants have the correct incentives to engage with an application initiated process.

3.3.2 Lessons learned from Snowy region related proposals

The Commission's experience in managing multiple Rule change proposals to change the Snowy region has provided practical information about an application process for region change. The Commission has made refinements at the practical level to the MCE's proposed process in light of this experience.

For example, the MCE proposed that the Commission be empowered to consider and accept, if appropriate, alternative region solutions put forward in submissions on a region change application. While there is merit in the intent of that proposal, the Commission's experience demonstrated the problems with receiving alternative proposals at later stages of the Rule change process. To avoid encountering those problems as part of the region change process, the draft Rule only permits alternative region solutions to be put forward in submissions as part of first round consultation (see Section 3.4). This will enable the Commission to consider all possible alternatives simultaneously when making a draft region determination.

The Commission's experience with the Snowy region proposals has also identified some gaps in the MCE's proposal, particularly related to the implementation of a region change. Since a region change had never been undertaken when the MCE proposed its Rule change, there is limited detail in the MCE proposed Rule on the actual implementation of a region change. While drafting the Rule to abolish the Snowy region, the Commission and NEMMCO identified the numerous steps required for implementing a region change. These are discussed in Section 3.9.

These, and other lessons, are elaborated on further in the below Sections.

3.3.3 Preparing an application for region change

An effective application initiated approach requires robust and objective criteria for initial acceptance of a region change application. This is important to minimise the scope for inadequate or misconceived applications. It also ensures that the costs and uncertainties of a region change process are only incurred when there is a economic case for doing so. The MCE proposal notes that the adoption of stringent application

requirements, including meeting pre-conditions linked to key elements of the congestion management regime, will help to reduce the incidence of such applications.³⁰ The Commission considers that the following framework, based on the notion of a “complete” application, addresses these concerns effectively and proportionately.

Consistent with the MCE proposal, clause 2A.2.1(a) of the draft Rule empowers any Registered Participant or NEMMCO to make a region change application to the Commission, but requires that any application must be complete (clause 2A.2.1(b) of the draft Rule). For the avoidance of doubt, this requirement applies to any change to the regions, including changes that have the effect of abolishing existing regions. A complete application must address the following four criteria (clause 2A.2.1(c)):

- Identify a congestion problem (clause 2A.2.2);
- Present a preliminary case as to the economic efficiency of a proposed region solution (clause 2A.2.3);
- Propose a technically competent alternative (clause 2A.2.4); and
- Demonstrate that the proposed region solution is the appropriate response (clause 2A.2.5).

The Commission considers that, collectively, these requirements establish an appropriate and proportionate benchmark for a prospective applicant to meet before the matter is progressed any further, recognising the costs and uncertainty that can arise in the market through the prospect of region boundary change. Sections 3.3.3.1 to 3.3.3.5 describe in more detail what an application must include in order to meet each of these criteria, and therefore, become a complete application.

The scope of the material required at this preliminary stage in the process is defined by the problem that the applicant is seeking to address. For example, it is not intended at this stage to require an applicant to provide detailed economic modelling of the likely impacts of the proposed solution to the problem being identified. As discussed in the following Sections, however, the applicant needs to provide sufficient information to satisfy the Commission that the application is genuine and meritorious, and that the applicant is prepared to commit the required resources to support more rigorous assessment through the process.

From its experience with the Snowy region, the Commission is cognisant of the resource intensive nature of analysing and assessing region changes. The Commission views that an initial application hurdle, while creating a direct compliance cost, is necessary and proportionate. A process which results in poorly specified or insubstantial region change proposals progressing to formal assessment and determination is likely to impose greater and potentially unreasonable costs on the Commission and stakeholders who are then burdened with analysing the potential effect of the application. The Commission also notes that detailed technical assessments of market developments in many cases constitutes prudent commercial

³⁰ MCE Rule change proposal, p.4.

practice, which suggests that the net additional compliance costs might be relatively limited in magnitude, and are unlikely to deter or delay substantive applications.

3.3.3.1 Defining a congestion problem

Clause 2A.2.2 of the draft Rule requires a complete application to identify a problem with the existing region boundary configuration, which is attributable to the presence of enduring network congestion, and which is likely to detract materially from economic efficiency if allowed to continue. For the avoidance of doubt, the Commission considers enduring congestion excludes congestion that occurs in non-system normal circumstances.

The information and analysis required to satisfy this requirement needs to be forward looking in nature, although the application might present historical information to set the context. How applicants are required to demonstrate there is a congestion problem is an important design issue for the draft Rule.

The Commission notes the various measures that have been suggested as possible candidates for thresholds for accepting or assessing applications, e.g. measures of dispatch efficiency. The MCE proposed that the Commission consider the economic criteria and thresholds identified in the CRA Final Report, such as [\$xxx] or [x%] of gross value of energy traded in the market for example.³¹ However, there is a significant risk that such an approach would be unduly partial and prescriptive. The Commission considers that it is important for the draft Rule to provide a degree of flexibility as to how the applicant seeks to demonstrate the economic case for changing regions. The analytical work undertaken by the Commission as part of CMR, and in assessing the Rule changes relating to congestion in the Snowy region, have clearly demonstrated that the economic impacts of congestion are multi-faceted and can vary on a case-by-case basis.

Several first round submissions noted the importance of clarifying the quantitative methodology used to inform the economic assessment, to support efficient preparation and evaluation of applications. It was suggested that the Commission should make key elements of the quantitative methodology explicit, to help reduce uncertainty and compliance costs, and to improve predictability of decision-making from a participant perspective.³²

The Commission considers it appropriate within the draft Rule (clause 2A.2.2(3)) to specify a framework for presenting information and analysis on perceived economic inefficiencies with the prevailing regions, spanning:

- Productive efficiency – including bidding incentives and dispatch outcomes;
- Efficiency in relation to risk management and forward contracting; and
- Dynamic efficiency – including impacts on investment decisions.

³¹ MCE Rule change proposal, p.6.

³² Ergon Energy, first round submission, MCE Rule change proposal, p.1; ERAA, first round submission, p.1; NGF, first round submission, MCE Rule change proposal, p.2.

Within this broad framework, each applicant would have discretion as to how it wishes to marshal its information and analysis and present its case. However, as supported by the MCE in its proposal, the Commission would expect applicants to focus on forward-looking analysis using generally accepted quantitative techniques. Rather than requiring a specific quantitative methodology however, where economic modelling is used, the Commission would expect such modelling to be transparently and comprehensively documented – and based on accurate technical and commercial representations of the NEM and its market rules at the relevant point in time. Applicants would also be expected to make use of existing indicators of congestion and its effects, such as measures of “mis-pricing”, where appropriate and relevant to the case being made.

3.3.3.2 Presenting a preliminary case for change

Clause 2A.2.3 of the draft Rule requires a complete application to present a preliminary case explaining how the proposed region solution would or would be likely to materially improve economic efficiency. The Commission, consistent with its view on how the congestion problem should be defined, considers that the applicant should have a degree of flexibility in how it presents its case within the broad framework of the efficiency criteria discussed above.

The Commission would expect applicants to make use of a range of analytical methods to demonstrate their case in particular circumstances, while retaining the focus on forward looking economic assessment. The Commission considers this approach, as compared to a prescriptive approach to thresholds and/or analytical methods required to demonstrate the attainment of such thresholds, as being an approach more conducive to robust, comprehensive assessment.

The MCE proposal raises the possibility of applying pre-determined threshold values to assess the materiality of any net economic efficiency dividends associated with a particular region change proposal. The MCE proposed that the thresholds identified in the CRA report should form the basis for consultation.³³ The MCE proposal also states that the Commission should be guided by stakeholder responses when setting definitive thresholds, and that appropriate variations are within the scope of its Rule change request.³⁴

CRA acknowledges that its dispatch efficiency threshold is indicative and does not adequately address allocative and dynamic efficiency. However, CRA notes the problematic nature of forward-looking modelling, especially in relation to estimating the potential longer-term allocative and dynamic efficiency benefits that may be associated with a regional change. Despite these weaknesses, CRA concluded that use of partial indicators, such as its \$1 million per annum dispatch efficiency threshold, would provide a robust, relatively simple measure that would help to

³³ The CRA thresholds are reproduced in Section 1.1.3 of this draft Rule determination.

³⁴ MCE, p.6.

more clearly define materiality in this context and improve the predictability of decision-making for proponents.³⁵

Responses were mixed on the nature, level, and appropriateness of using pre-determined thresholds in this context. Some submissions fundamentally questioned the appropriateness of prescribing arbitrary thresholds.³⁶ Others questioned the level of the threshold, noting that the margin for error associated with forward-looking modelling may be greater than the proposed threshold.³⁷ Views on what constitutes an appropriate dispatch efficiency threshold ranged from between \$1 million per annum up to \$5-\$10 million per annum.³⁸ CRA acknowledges this inherent weakness, noting that the level of the threshold is a matter of judgement.³⁹

The Commission's own quantitative analysis suggested dispatch efficiency gains from abolishing the Snowy region averaged around \$1 million per annum, depending on the contracting assumptions.⁴⁰

While the Commission recognises the need to consider dispatch efficiency, and the value of forward looking economic modelling in this regard, it does not support the use of pre-determined thresholds. An assessment of region change options needs to examine short term and longer term impacts. While this requires the Commission to balance a range of information and analysis, some of which will be less certain and more qualitative, such a holistic assessment is preferable to a more deterministic, but partial assessment.

3.3.3.3 Proposing a technically competent application

Clause 2A.2.4 of the draft Rule requires an application to be technically competent. The purpose of this requirement is to ensure that any application coming forward is coherent, i.e. if the application was progressed and subsequently implemented, then the result would be a set of clearly defined, functional regions. Clause 2A.2.4(1) sets out the specific technical requirements that the application must address. This requirement does not relate to whether the proposed change is desirable from the perspective of economic efficiency, or sensible and timely from a procedural perspective. It is a test of whether the application "makes sense" operationally. Examples of technically incompetent applications might be those which fail to define a RRN, or which result in a number of connection points not being allocated to a region, or to more than one region.

³⁵ CRA, Transmission Region Boundary Structure Final Report May 2005, p.47-52.

³⁶ For instance, see Ergon Energy, first round submission, p.2; Origin Energy, first round submission, p.5.

³⁷ For instance, see Origin Energy, first round submission, p.3; NGF, first round submission, p.3; ERAA first round submission, p.2.

³⁸ For instance, see Origin Energy, first round submission, p.3; Ergon Energy, first round submission, p.2; TRUenergy, first round submission, p.2; Delta Electricity, first round submission, p.2.

³⁹ CRA, Transmission Region Boundary Structure Final Report May 2005, p.51.

⁴⁰ AEMC 2007, *Abolition of Snowy Region*, Rule Determination, 30 August 2007, Sydney, p.116.

The Commission recognises that in order to provide a technical competent application, an applicant may require information from NEMMCO. Clause 2A.2.7 of the draft Rule provides an applicant the power to request information from NEMMCO in order to prepare a technically competent application, and requires NEMMCO to provide such information.

A region change will require an implementation period, which is the period of time between publication by the Commission of its region determination and the date on which the new regions would take effect. The standard implementation period is three years from the date of final region determination. Where a region change application proposes an implementation period that is more or less than the standard three year period, that application must (in order to be technically competent) specify the reasons why a different period should be determined by the Commission (2A.2.4(b)).

As discussed above in Section 3.2, the Commission is seeking views on how best to distinguish those technical aspects of a region description that may change over time from the “fixed” descriptors, which can only be changed by a region change application process. There is a question as to whether the Commission is making a decision on all the technical aspects required for a technically competent application or only the three described in Section 3.2, i.e. the RRN, connection points, and metering points. The Commission welcomes views on this issue.

3.3.3.4 Demonstrating the appropriateness of the region change response

In its proposal, the MCE notes that the Commission:

“should clarify the procedural order of regional boundary reviews within the broader investment framework, including the relationship between regional boundary arrangements, the regulatory test, congestion management and the [Last Resort Planning Power (LRPP)].”⁴¹

The MCE envisages that:

- A local application of a congestion management regime would be applied where material congestion emerges;
- Where commercially material congestion persists and is not addressed by market or regulated investment, it “may be appropriate” for the Commission to invoke the LRPP; and
- A region boundary review may be initiated by the Commission where the LRPP has been applied and there has been no commitment to complete an investment to address the congestion within two years.⁴²

⁴¹ MCE Rule change proposal, p.4-5.

⁴² MCE Rule change proposal, p.5.

Further clarification of the relationship between the region change process and other elements of the congestion management regime was supported in several submissions.⁴³

The Commission agrees that a region change is a long term response to material and enduring congestion issue. There are a number of other steps other than region changes that support the management of congestion in the NEM over time, as highlighted by the MCE. These steps, and how they fit together with region change, are under consideration as part of the Congestion Management Review. The Commission does not consider, however, that a clear sequence of events can be pre-defined. The circumstances of each region change application will differ, as will the relevance of particular means of managing congestion in those circumstances. The draft Rule should reflect this reality.

The principle that does apply in all circumstances, however, is that region change should be considered only where there is enduring congestion with material economic effects. The Commission has concluded, in accordance with the MCE's policy intent, that an applicant must demonstrate an awareness of these alternatives, and explain why they are less appropriate than a region change in the particular context of its application (clause 2A.2.5).

Within the NEM's regional structure, price differences between regions provide important signals for the market. The regional structure needs to be sufficiently stable to enable these price signals to be understood and acted upon by market participants. The draft Rule therefore requires the applicant to demonstrate, under this part of its application, that the congestion problem will endure long enough for the proposed region change to deliver material net economic benefits allowing for efficient market-based response from generation or load, e.g. the location of a new generator or major industrial load (clause 2A.2.5(b)(1)).

The draft Rule also requires the applicant to be cognisant of the role of transmission solutions in managing congestion in the NEM (clauses 2A.2.5(b)(2) and 2A.2.5(b)(3)). Transmission Network Service Providers (TNSPs) have an important role to play in identifying and responding to demonstrated needs for transmission capability. Responses can involve investment solutions, such as the construction of a new transmission circuit, and non-build solutions, such as contractual arrangements with loads or generators to support the provision of additional network capacity, e.g. by agreeing to reduce their load at short notice. The Commission has made substantial amendments to the Rules in respect of the regulation of TNSPs and the incentives they face to promote efficient operation. From the perspective of congestion management and region change applications, these processes need to be given time to operate. The draft Rule therefore requires an applicant to demonstrate why it considers the congestion problem to be an enduring issue in the light of efficient

⁴³ For instance, see CS Energy, first round submission, p.2; Hydro Tasmania, first round submission, MCE Rule change proposal, p.1-2; NGF, first round submission, p.1-2; Origin Energy, first round submission, p.4-5; Powerlink, first round submission, MCE Rule change proposal, p.1; Snowy Hydro, first round submission, MCE Rule change proposal, p.1-2; ERAA, first round submission, p.2; TRUenergy, first round submission, p.1-2, 4.

behavioural responses from TNSPs. This highlights an important interaction between region change and the Regulatory Test for transmission investment.

An element of the regulatory regime that an applicant must also have regard to is the LRPP. The MCE proposal also implies a sequential relationship between the LRPP and region change, with the LRPP being completed prior to initiating a region change process. The Commission do not consider this to be necessary. If the applicant can demonstrate why a region change is a more efficient response than a transmission reinforcement, and that this stands up to scrutiny through consultation with stakeholders, then the fact that the LRPP process has not been triggered appears to have only limited relevance. In fact, it might indicate that region change applicant has a strong argument.

While it might be the case that the submission of an application prompts the Commission to consider whether the LRPP should be exercised, this is a different consideration. In this event, the Commission would have the flexibility to run the LRPP and the region change process in parallel, as Origin Energy proposed in its submission.⁴⁴

In its proposal, the MCE anticipated a process where “commercially material” congestion would be “priced by a congestion management regime”, as specified in the Rules. If these signals suggested the commercial impact of the congestion was material and enduring, the MCE considered the AEMC should factor that into any assessment for a region change.⁴⁵

The Commission’s Draft Report on CMR discusses what role the Commission foresees for congestion pricing mechanisms, like that anticipated by the MCE, in the context of designing a congestion management regime for the NEM.⁴⁶ While its work on CMR is ongoing, in the context of considering applications for region change, the Commission does not consider at this time that a pricing mechanism is a necessary precondition that should be explicitly specified in the Rules.

3.3.3.5 Previous consideration of a region change application

A final element of the procedural case for change, and an important element of the MCE proposal, is the principle that the Commission should be able to reject an application if it relates to a congestion problem which has already been considered in the last five years. The Commission considers that this should be discretionary, rather than mandatory. A mandatory bar on applications on these grounds might have unintended consequences, e.g. to encourage misconceived applications. It might also result in valid cases for region change not being able to be considered, e.g. if circumstances have changed substantially since the congestion issue was considered previously.

⁴⁴ Origin Energy, first round submission, p.1-3.

⁴⁵ MCE Rule change proposal, p.5.

⁴⁶ AEMC 2007, *Draft Report, Congestion Management Review*, 27 September 2007, Sydney.

In the Commission's view, an effective way to incorporate this policy intent within the draft Rule is to require an applicant to demonstrate why it is appropriate for the Commission to reconsider an application relating to a congestion problem that has been the subject of a previous accepted application in the past five years (clause 2A.2.6). If the applicant is unable to cite material changes in the circumstances since the earlier application, this would be a factor in the exercise of the Commission's discretion not to accept the application.

3.3.4 Determining a complete application

The draft Rule requires the Commission to decide whether or not the region change application is complete. If the Commission does not consider that the application meets the requirements as discussed above, it must notify the applicant, in writing, of the reasons for its decision. It is not required to further consider the application until it is satisfied that the application is complete (clause 2A.2.8).

If the Commission decides that the proposed region change application is a complete application, it is required to publish the proposed application on its website and undertake a preliminary consultation on whether it should accept the application and therefore commence the full process of considering the region change (clause 2A.3.2(a)).

The purpose of this preliminary stage of consultation is to obtain the views of informed and interested parties on whether the application is sufficiently well developed prior to formally accepting a region change application and commencing the full consultation process to assess that application. To the extent that the preliminary consultation identifies potential issues with the application, the Commission may invite the applicant to provide additional information or to amend its application before making a decision on whether to accept the application (clause 2A.3.2(b)).

The Commission considers that this additional and early procedural step is an effective means of obtaining views and information from third parties to inform its decision to accept an application.

3.3.5 Accepting a region change application

Having taken account of any comments raised in the preliminary consultation, the draft Rule requires the Commission to determine whether to accept a region change application. Under clause 2A.3.1(a) of the draft Rule, the Commission may only accept an application that it concludes is complete and in which the applicant has demonstrated its case substantively to the satisfaction of the Commission.

If the Commission considers an application is not a complete application or whether, a result of comments received in preliminary consultation or otherwise, that the region change application should not precede, it may make a decision not to accept the application (clause 2A.3.1(b)). It will then publish its decision together with its reasoning for not accepting the application (clause 2A.3.1(c)).

If the Commission is satisfied that the application is complete, addresses any issues raised during the preliminary consultation, and should be further considered, then it must accept the region change application and commence first round consultation (clause 2A.3.1(d)).

An applicant is unable to withdraw a region change application once the AEMC has determined to accept the application and published a notice of first round consultation (clause 2A.3.1(e)). The Commission believes that once a public consultation process has commenced, applicants should not be able to unilaterally withdraw an application from that public process.

3.3.6 Proposed guidelines

Several submissions suggested that the Commission prepare explanatory guidelines to improve certainty and reduce compliance costs for potential proponents. The Commission would like to test this proposition again with stakeholders, in the light of the draft Rule, which provides a greater degree of specification as to what is required of a region change application. The Commission considers that the scope of guidelines would be limited to elaborating on the procedural requirements for applicants and other stakeholders who wish to engage in the process, e.g. applicants of alternative region change options.

In principle, the Commission agrees that guidelines have the potential to help clarify and improve transparency and reduce compliance costs. The Commission has, for example, published guidelines to promote effective implementation of other Rule changes; most recently with the LRPP Rule. However, the Commission is also mindful of the need to limit the publication of guidelines to instances where they add value to the process.

The Commission would develop any guidelines in conjunction with stakeholder consultation. They would then be available as a resource for applicants and other interested parties to have regard to when considering region change applications. The Commission would welcome views on the need for, and detailed scope of, guidelines in the light of its draft Rule determination and draft Rule on the process for region change, given the level of prescription and guidance to applicants provided in the draft Rule itself.

3.4 First round consultation

Once the Commission accepts a region change application, it is required to commence first round consultation on the application. The consultation notice will contain the application and any further supporting information and analysis provided by the applicant, and will invite submissions and comments from any person within 75 business days (clause 2A.4.1).

The first round consultation notice may also invite interested persons to put forward alternative region solutions to those contained in the region change application. This may be by way of either an “informal” alternative solution or a “formal” alternative solution. In the case of an informal proposal, the AEMC would not be bound to consider this as a fully developed proposal and it could not give rise to the potential

for further supplementary analysis to be required. For a “formal” alternative region solution, there are a series of requirements and the AEMC may direct the production of economic analysis.

3.4.1 First round submission may propose an alternative region solution

The MCE proposal seeks to create an innovative evaluation framework based on the notion of a “parallel” assessment process. Under this process, stakeholders would have the potential during the first round consultation to identify practical alternatives to the proposal presented in a region change application. Similarly, the Commission would be able to identify alternatives other than those advocated by stakeholders.

A parallel assessment process may possess several advantages including:

- A significantly streamlined process, which would reduce administration costs and the duration of periods of market uncertainty over future region changes;
- Improvements to the quality of decision-making by enabling the Commission to undertake a comprehensive comparative assessment of all practical alternatives simultaneously;
- Increased transparency by enabling stakeholders to propose alternatives, and consider and comment on the full range of practical options within a single evaluation process; and
- Reduced incentives for inadequate applications by creating the possibility that an alternative proposed by a competitor or some refinement adopted by the Commission may proceed, which may be less compatible with the proponent’s commercial interests.

The lack of such a process in respect of the Rule changes relating to congestion in the Snowy region has, in the Commission’s view, resulted in a level of procedural complexity that is unnecessary and unhelpful going forward.

The Commission proposes to give the MCE policy intent a more formal framework by enabling a submission to the first round consultation to be formally identified as an alternative region solution (clause 2A.4.3). A proposed alternative region solution would be required to be clearly marked as such (clause 2A.4.3(b)). An alternative region solution put forward in a submission would also be required to meet the same informational requirements to describe that solution as a region change application (set out in clauses 2A.2.3-2A.2.5).

An alternative region solution would not be required to demonstrate that there is a congestion problem, since this would already have been identified in the original region change application. A submission that proposes an alternative region solution for formal consideration would, however, need to demonstrate that the solution relates to the same congestion problem as the original application.

Finally, as is the case with a region change application, a submission that proposes an alternative region solution is only required to include a preliminary case as to the

economic efficiency of the alternative region solution proposed when compared to the continuation of the prevailing regions.

3.4.2 Provision of supplementary economic analysis

Once accepted, the Commission may direct the applicant of a region change application to submit supplementary economic analysis to strengthen and deepen the information base for assessment (clause 2A.5.1(a)). The same applies to a body or person who has put forward an alternative region solution in a submission, which the Commission has accepted (clause 2A.5.1(b)). The Commission may not direct a person to provide supplementary economic analysis if their submission does not expressly identify that the submission is to be treated as a formal alternative region solution (clause 2A.5.1(b)). If the Commission gives a direction for supplement economic analysis, it may do so anytime after the start of first round consultation (clause 2A.5.1(d)). The Commission's direction may specify the period of time for providing supplementary economic analysis (clause 2A.5.1(c)).

Supplementary economic analysis may include economic modelling, which may require NEMMCO to provide information, e.g. a set of system network constraints oriented to the proposed new region configuration.

The Commission's experience in handling the Rule change proposals relating to congestion in the Snowy region demonstrated the benefits of such analysis, but also revealed that providing the supporting information to facilitate such analysis is a substantial undertaking for NEMMCO. The Commission considers, therefore, that only when a region change application has commenced first round consultation or when an alternative region solution put forward in a submission has been accepted as complete should the Commission contemplate whether supplementary analysis is required.

Neither a person or body making a region change application nor a person or body proposing a formal alternative region solution in a submission may require NEMMCO to provide information to support its supplementary economic analysis. The draft Rule empowers the Commission to request NEMMCO to provide factual information to support this task (clause 2A.5.2). NEMMCO is required to provide that information. The Commission would intend to consult informally with NEMMCO as to what constituted a reasonable period of time to allow for its provision of supporting information before it issues a direction for the submission of supplementary information. If required, the draft Rule also empowers NEMMCO to direct the relevant TNSPs to provide information related to network constraints with respect to a region change application or an alternative region solution (clause 2A.5.2(c)).

3.4.3 Timeframes for first round consultation

The Commission recognises that compliance with a direction to provide supplementary economic analysis is a significant undertaking, requiring substantial time and resources. To assist directed parties, the Commission has increased the MCE proposed timeframes for consultation from 40 business days to 75 business days, with discretion for longer timeframes if required, e.g. to ensure consistency

with Commission direction in respect of the submission of supplementary information (clause 2A.9.1). The timeframes for the region change process are discussed further in Section 3.8 below.

3.5 Making a region determination

3.5.1 Commission powers to make region determination

Clause 2A.6.1 of the draft Rule sets out the scope of the Commission’s discretion in making a region determination. In making a region determination, the point of reference for the exercise of the Commission’s discretion is the congestion problem identified by the original region change application. The Commission is empowered to:

- Accept or reject the region change solution proposed in the original application;
- Accept or reject a formal alternative region solution put forward in a submission;
- Determine a materially different region change solution than the one proposed in the original application;
- Determine a materially different region change solution than a formal alternative region solution proposed in a submission; and
- Determine that no region change should be made.

The Commission is able to adopt the region change solution that it considers provides the best available solution to the congestion problem identified in the original region change application (clause 2A.6.1(b)).

The Commission considers that the level of discretion proposed has the potential to improve the efficiency of the region change process and allow for more effective market development outcomes, consistent with its duties under the NEL. It notes that its Rule change experience to date suggests that applications motivated by self interest alone may not always disclose the “best” options from a market development perspective. It also notes that region change is fundamentally about efficient market development, not Rule change. Greater latitude afforded by the proposed level of discretion would potentially allow the Commission to identify the best option for the market as a whole. The Commission’s discretion is constrained by the congestion problem identified by the region change application.

3.5.2 Matters for consideration when making a region determination

The Commission may only make a region determination to adopt a region change solution if it satisfied that the solution meets a defined set of criteria (clause 2A.6.2). In addition, the NEL requires the Commission to have regard to the NEM Objective in exercising any of its functions, which would include making a region determination. The draft Rule is designed to expand at a more specific level on the issues the Commission should consider when making a region determination.

In formulating these criteria, the Commission has had regard to its experience in assessing the Rule changes relating to congestion in the Snowy region. The final and draft Rule determinations published by the Commission in respect of the Snowy region related Rule change proposals applied a set of seven assessment criteria:

- The likely effect on the economic efficiency of dispatch;
- The likely implications for allocative and dynamic efficiency of associated pricing outcomes and related participant responses;
- The likely effect on inter-regional trading and risk management and its implications for allocative and dynamic efficiency, and competition;
- The likely effect on power system security, supply reliability, and technical operation;
- Consistency with good regulatory practice;
- The likely long-term implications and consistency with public policy, including any MCE policy statements; and
- Implementation implications.

The Commission views that this set of criteria provided a broad and robust framework for its assessment of these proposals on a comparative basis. This has direct relevance to the assessment of region change more generally going forward. The assessment criteria specified in the draft Rule are, however, more limited in scope than the criteria adopted for assessing the Snowy region related Rule change proposals, focusing on the economic efficiency and power system security. The draft Rule has itself been structured to deliver a procedure that is consistent with good regulatory practice and with long term policy settings. As such, it appears unnecessary to include such considerations formally at the end of process in assessing the individual merits of particular region change solutions.

In making a region determination, clause 2A.6.2 of the draft Rule proposes that the Commission must be satisfied that a region change:

- Addresses a material and enduring congestion problem;
- Is technically competent;
- Represents a timely and appropriate response to the identified congestion problem having regard to alternative means of managing congestion;
- Represents the region change best calculated, having regard to the accepted application and any accepted alternatives, to promote economic efficiency in the NEM in the short and long term, where economic efficiency shall include:
 - productive efficiency;
 - efficiency in risk management; and
 - dynamic efficiency;

- Is consistent with the continuing safe, secure and efficient operation of the power system; and
- Can be implemented effectively and efficiently.

3.6 Draft region determination

The Commission must issue a draft region determination (rule 2A.7) for the purposes of a second round of consultation. The standard period for the Commission to issue its draft region determination is within 60 business days of the end of first round consultation (clause 2A.7.1). The draft Rule provides for a longer period of time to be set, if required (clause 2A.9.1). This might, for example, be appropriate if a number of alternatives are proposed and accepted, and if substantial supplementary analysis is deemed to be required to inform the Commission's assessment.

The Commission will publish its draft region determination through a second round consultation notice, inviting submissions from any person within 60 days of the publication of the notice (clause 2A.7.2(b)).

A draft region determination must contain the Commission's reasons for its decision with reference to the assessment criteria as discussed above in Section 3.5.2. The draft region determination will present a comparative assessment of the original region change application and all accepted alternative region solutions, against the base case of the continuation of the prevailing regions and against each other. It will use the cumulative information and analysis gathered through its preliminary and first round consultation, and any supplementary economic analysis, to re-appraise the questions originally considered in accepting the application or an alternative, and will examine the wider questions of the relative impacts on the operation of the power system and the practical question of effective implementation.

3.7 Final region determination

The final stage in the consultation process is for the Commission to issue a final region determination within the standard period of 40 business days from the close of second round consultation (clause 2A.8.1(a)). The final region determination will review the assessment made at the draft region determination stage in the light of stakeholder submissions and any other relevant new information, and present a final decision and reasons for that decision (clause 2A.8.1(b)). The Commission must publish a notice of the region change if it determines to make such a change in its final region determination (clause 2A.8.2). The final region determination will also trigger the implementation of the associated region change(s).

3.8 Consultation provisions

3.8.1 Standard consultation timeframes

The MCE proposal recognises that the process of region change will generally require more time than considering a standard Rule change proposal. However it

also notes the need for timeframes to be specified in the process for region change draft Rule. It proposes 180 business days from “Notice of Proposed Region Boundary Change” to publication of a final region determination, compared to 110 business days at present for a standard Rule change process.

Few submissions responded on the standard consultation timeframes proposed for the evaluation process. CS Energy suggested that the assessment timeframes should be kept to a minimum to reduce market uncertainty that could affect financial contracting and investment decision-making.⁴⁷ Delta Electricity noted similar concerns about uncertainty, suggesting that the evaluation process needs to be transparent and predictable to allow participants to effectively manage related operational disruptions.⁴⁸

The Commission agrees that a region change process is different to a Rule change, and that timeframes should be specified in the Rule. Its work on the Snowy region related proposals has demonstrated the significant time and material resources required to consider a region change. However, as with the Rule change process, these timeframes should be capable of being adjusted by the Commission if required, as set out in clause 2A.9.1 of the draft Rule.

The process for region change set out in the draft Rule includes a preliminary consultation stage before a region change application is accepted. This is not a standard feature of a Rule change, and reflects the Commission’s views that an application should be fully formed and subject to initial scrutiny before the process is initiated, particularly given the significant costs and uncertainty involved in initiating a process to change region definitions in the NEM.

Timeframes need to be set at levels consistent with timely decision making, but should also be consistent with effective stakeholder engagement. This is particularly important for the region change process because of the role of stakeholders in helping guard against misconceived applications, and in developing alternative region solutions to ensure each application and alternative is assessed effectively and completely. The Commission considers, in the light of stakeholders views and its own experience in handling the Snowy region Rule change proposals, that the following timescales represent appropriate defaults for inclusion in the process for region change draft Rule:

- Twenty-one business days for stakeholders to provide submissions and comments on the preliminary consultation as to whether or not the Commission should to accept a region change application (clause 2A.3.2);
- Seventy-five business days for stakeholders to provide submissions and comments (including the submission of alternative region solutions) in response to the first round consultation (clause 2A.4.1(b)(2));
- Allow sixty business days from the end of the first round consultation period for the Commission to prepare its draft region determination (clause 2A.7.1(a));

⁴⁷ CS Energy, first round submission, p.2.

⁴⁸ Delta Electricity, first round submission, p.2.

- Allow sixty business days for stakeholders to respond to the second round consultation (clause 2A.7.2(b)(2)); and
- Allow forty business days from the end of the second round consultation period for the Commission to prepare its final region determination (clause 2A.8.1(a)).

The standard consultation periods proposed above imply a period of 256 business days from the start of the preliminary consultation to the issuing of the final region change determination. This compares to 180 business days proposed by the MCE and the 110 business days for the standard Rule change process. The Commission considers that planning for a region change process to take five months longer than a standard Rule change is realistic and proportionate. The Commission welcomes views on these standard consultation periods.

3.8.2 Consultation meeting

The MCE proposal incorporates provisions requiring the Commission to convene a public hearing on request during the first and second consultation rounds. Effective consultation is a critical component of the proposed parallel evaluation process. However, it is not clear whether the proposed provisions that require the Commission to convene a public hearing if requested by registered participants or interest parties will necessarily add to the effectiveness of the consultation process.

The standard Rule change process also includes provisions for public hearings during first and second round consultation. However, the Commission has discretion to refuse a request for a public hearing under the standard Rule change process. Such discretion allows the Commission to pursue a public hearing where it would make a material contribution to the efficiency and effectiveness of a Rule change process. It also reduces the potential for a public hearing to be used to distort or delay a Rule change process. In view of the complex nature of assessing a region change application and the relatively tight timeframes proposed for undertaking a region change process, it would seem appropriate for the Commission to exercise similar discretion in this context (clause 2A.9.2).

The Commission would be guided by the views of stakeholder on the value of convening a consultation meeting at the first consultation round and/or second consultation round stage. A consultation meeting might be appropriate, for example, when numerous alternative region solutions have been proposed and accepted by the Commission, or where the Commission has received numerous pieces of supplementary economic analysis. A consultation meeting, before the end of first round consultation, might be an effective means of enhancing the ability of interested parties to engage in the consultation in an informed manner.

3.8.3 Consultation with jurisdictions

The MCE proposal suggests that the Commission should consult with affected jurisdictions where a proposed region change may have implications for retail pricing. Some submissions expressed concern about this requirement, suggesting that it may unduly compromise Commission decision-making.

The Commission considers such consultation to be consistent with good regulatory practice, and notes that it is not bound by the views of jurisdictions expressed during such consultations. The Commission also notes that such consultation is essentially an operational practice that does not need to be codified in the Rule. Hence, the Commission did not include reference to this practice in the draft Rule. The Commission intends to continue its practice of consulting with jurisdictions which may be affected by a proposed region change.

3.9 Implementation

The Commission's experience in handling the Rule change proposals relating to the Snowy region illustrated the need to consider implementation issues, ideally at a relatively early stage in the process. It considers that a number of detailed issues would have been identified, and could have been resolved, earlier as a result. Part B of the draft Rule seeks to create a generic regime that would allow for the implementation of a region change in a variety of circumstances.

3.9.1 NEMMCO Region Change Implementation Procedure

It is best to identify issues of implementation as early in the process as possible. Following from its Snowy region experience, the Commission believes that implementation procedures have a general value to the consultation process in advance of the Commission making a final region determination.

The Commission considers that an effective and proportionate means of providing greater visibility to implementation issues at an earlier stage in the region change process is for NEMMCO to have an obligation to compile and publish a draft "Region Change Implementation Procedure" for publication no later than the end of the second round consultation period, i.e. following publication by the Commission of its draft region determination. This would enable stakeholders to comment on the implementation issues associated with a region change option that the Commission is minded to implement before the decision is finalised. This, in turn, allows the Commission to have full regard to implementation issues, informed by stakeholder comments, when it makes its final region determination. Rule 2A.11 of the draft Rule sets out the requirements on NEMMCO for preparing and finalising the Region Change Implementation Procedure.

3.9.2 NEMMCO region change implementation functions

Rule 2A.12 of the draft Rule sets out the implementation functions NEMMCO requires in order to implement a region change. This rule covers general implementation functions, which must be referable to the published Region Change Implementation Procedure (2A.12.2). Clause 2A.12.3 of the draft Rule refers specifically to NEMMCO's ability to amend its Regions Publication and Loss Factors Publication as part of the implementation of a region change.

3.9.3 Lead times

The MCE proposed that region changes should have an implementation lead time of three years from the date of the final region determination. First round submissions were generally supportive of the proposed three year implementation period, noting that it would represent a reasonable minimum transition period during which contracting positions could be efficiently adjusted and trading platforms developed to accommodate a new region configuration. A significantly shorter implementation period may have the potential to add undue cost and uncertainty to the region change process.

However, other stakeholders made more general observation about the duration of the whole process, recognising potential interactions with other processes, e.g. the LRPP process. Several stakeholders including Powerlink, TRUenergy and ERAA noted the possibility for delays, especially in relation to the potential interaction between the LRPP and the region change process, and suggested that the Commission should adopt a flexible approach to ensure that efficient region changes are not unduly delayed.

The Commission considers that implementation lead times shorter than three years might be appropriate in some circumstances, and there might be value in providing for this flexibility in the region change process draft Rule. The Commission would welcome stakeholder views on accelerating the implementation phase where this course of action can be demonstrated to be in the best interests of the market and is broadly supported by stakeholders. It would also welcome views on the minimum implementation period that should apply regardless of circumstances.

In their submissions to the first round consultation, Delta and the NGF commented that the Commission should have a power under the process for region change Rule to reverse its decision on region change if there are material changes in circumstances during the three year implementation period. The Commission views that this would introduce an unnecessary and unacceptable degree of risk to the process, which conflicts with the rationale for implementation lead times. While it is extremely important for the process leading to a final region determination to be as robust as possible, including full consideration of the whether a congestion problem is enduring or not, the Commission does not consider a process that allows for decisions made under this process to be reversed lightly (with potential retrospective effects) is consistent with good regulatory practice.

3.9.4 Ex post evaluation

The MCE proposal proposes that the Commission conduct an ex-post review of region changes to evaluate the extent to which they have been successful.⁴⁹ However, the MCE proposal does not elaborate on the nature or features of the proposed review, nor does its proposed Rule.

⁴⁹ MCE Rule change proposal, p.6.

The lack of detailed guidance in the proposed Rule or in the MCE proposal raises some threshold process design questions for the Commission. How should a region change evaluation be accommodated in the draft Rule? What process should be adopted to undertake a region change evaluation? What criteria should be used to evaluate the “success” of a region change?

Submissions were also largely silent on these matters. NEMMCO and the AER both note that the evaluation proposal is not addressed in the proposed Rule and conclude that the Commission should seek to clarify the nature and intent of the proposed evaluation.⁵⁰ There were no other specific comments of substance on this issue. Generally though, stakeholders registered a clear preference for the region change process to promote predictability, transparency, and consistency, to reduce regulatory risk and uncertainty.

The notion of an ex post review is not a feature of the standard Rule change process; it arguably introduces a degree of regulatory risk to the overall process. In particular, it could create a perception of “conflict of interest” as the Commission would essentially be reviewing its own decision. This is the same sort of conflict of interest that the Commission considers would arise if it were to have a region change review function in absence of a region change application to address material and enduring congestion, as discussed in Section 3.3.1.

Further, the Commission notes the existing provisions under the National Electricity Law for the MCE to direct the Commission to undertake a review of particular aspects of the market arrangements. This power could be exercised to direct the Commission to undertake an ex post review of a region change, and would provide greater flexibility in the focus and terms of such a review.

The Commission does not therefore consider that including an ex post review function of region changes in the draft Rule would promote the predictability, transparency, consistency, or certainty sought by stakeholders in the NEM. The draft Rule does not provide for an ex post review. The Commission is seeking views from stakeholders on the value or otherwise of having an ex post review function.

⁵⁰ NEMMCO, first round submission, MCE Rule change proposal, p.3; Australian Energy Regulator, first round submission, MCE Rule change proposal, p.2.