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John Tamblyn
Chairman
Australian Energy Market Commission
PO Box H166
AUSTRALIA SQUARE NSW 1215

Dear Dr Tamblyn

National Electricity Rules: Rule Change Application
Rules to establish a comprehensive inter-participant framework for addressing network reconfiguration

We refer to the above Rule Change proposed by Stanwell and welcome the opportunity to respond to the submissions and issues that have been raised during the Rule Change consultation process.

Stanwell is pleased to see that during the consultation process that there has been extensive support for the Rule Change proposal from all manner of market participants. Of note is that the fact no outright opposition was expressed in relation to the Rule Change and no statement was made that any aspect of the proposed Rule would be contrary to the National Electricity Market Objective (**Market Objective**). Where submissions were not wholly supportive, these submissions generally raised points of detail that can be easily addressed or are, in Stanwell's view, misguided.

In any event, the consultation process and the submissions received by the Commission have raised some issues that Stanwell believes that, as Rule Change applicant, it is in a position to address. Attachment A to this letter therefore contains Stanwell's response to the submissions received and issues raised during the Rule Change consultation process. In particular, Attachment A addresses the following key questions:

- What projects should the Rule Change apply to?
- What process issues are raised by the Rule Change?
- What is the role of connection agreements in resolving the reconfiguration issue and is there an argument for reversing the direction of compensation?
- What is the difference between compensation and firm access?

- How can compensation be quantified?
- Is lost revenue a “cost”?
- Does the Rule Change merely represent the shifting of stranding risk from generators to networks or end customers?
- Can and should the Rules provide for the payment of inter-participant compensation?
- Is the Regulatory Test the appropriate mechanism for the identification of the costs and benefits of a reconfiguration?

Since the Rule Change application was initially lodged, the Commission has released a second draft of the *Draft National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006*. Attachment B to this letter therefore contains a revised draft of the proposed Rule Change that incorporates the proposed drafting and substantive changes made to National Electricity Rules in that second draft.

Should you have any questions, please do not hesitate to contact Erin Bledsoe on 07 3335 3804.

Kind Regards

Andrew Bills
General Manager
Business Expansion and Trading

Attachment A: Comments on submissions received and issues raised by the Stanwell Rule Change proposal

1 Overview

In addition to Stanwell's submissions in support of its Rule Change application, the Commission has received 5 other submissions during its consultation period. They highlight the following:

- the market considers the issue important;
- the generators as an industry have strongly supported the reform;
- 5 other individual generators have felt strongly enough to put their names to an individual submission to the Commission; and
- even the market participants who are responsible for planning (i.e. Vencorp) or who are network owners (i.e. ETNOF) either recognise the need for reform in this area or are willing to support key aspects of the reform proposals.

Importantly, none of the submissions dismiss the validity of the flaw that Stanwell has identified in the Rules and none express outright opposed to the Rule Change.

Nevertheless each of the submissions does put forward issues of detail or proposes drafting changes.

Furthermore, two are other issues are worthy of discussion. These are whether:

- the proposed Rule Change merely results in a shifting of standing risk (i.e. a mere wealth transfer); and
- the Rules can and should be used to establish an inter-participant compensation scheme.

2 What projects should the Rule Change apply to?

Initially Stanwell considered that its Rule Change should apply to all replacements and reconfigurations. However, following consultation with other industry participants, Stanwell's amended application now only seeks the application of the changed Rules to reconfigurations.

That is because, with respect to like for like replacements:

- in the long run, replacements will be of infrastructure that itself was already subjected to the Regulatory Test (or its antecedent regulatory checks); and
- by their nature, like for like replacements will not deprive users of functionality and will therefore not strand network users' assets.

In respect of that change, EnergyAustralia's submission states that:

> *EnergyAustralia is pleased that the Rule Change request has been changed to focus on reconfiguration of transmission investment, rather than capture distribution investments as well.*

Indeed, all submissions agree that the issue to be addressed is with respect to reconfigurations. There are, however, different views concerning what should constitute a reconfiguration.

On the one hand, EnergyAustralia is concerned that the change would apply to too many network initiatives:

> *The proposed definition makes it likely that all significant replacement projects would be considered as reconfigurations as it is difficult to identify a $10 million project that would not "modify the technical capabilities" of the network.*

However, the rest of the transmission sector disagrees and considers that the additional projects to be subject to the Regulatory Test would be few. ETNOF's submission states that:

> *In these relatively rare circumstances, ETNOF recognises and acknowledges the need to provide adequate notice of any network reconfiguration that affects customer access to the transmission network (whether generator or consumer), to allow the affected party to manage any potential impacts upon their business activities. Consequently, it is ETNOF's view that only network reconfigurations should be considered under this proposal.*

Vencorp's submission is probably the best explanation that reconciles EnergyAustralia and ENTOF's differing views. Vencorp is of the view that most of the projects that are "reconfigurations" are already caught by the existing Regulatory Test requirements and only a small number of additional projects would be subjected to the Regulatory Test. Vencorp states:

> *VENCorp believes that modification of the technical capabilities of a network is likely to enhance the network, which by definition is a network augmentation and the principles for this are already covered within the Rules.*

For that reason, these different responses from the transmission sector taken as a whole give Stanwell great confidence that the definition of reconfiguration in the proposed Rule Changes is appropriate.

The Group submission by 5 southern generators proposes a "fine tuning" change to that definition, which would see a network reconfiguration defined as follows:

> *"Works*, which are not *a new large transmission network asset* or *small transmission network asset* to:
>
> (a) Permanently re-route the path or the *network* or otherwise alter the configuration of the network"

Stanwell does not oppose that fine point of refinement.

3 What process issues are raised by the Rule Change?

Again, although supportive of the proposal that the market be made aware of reconfigurations, Vencorp is concerned that if the sole means of such communication is publication in the Annual Planning Report unwanted delay could result:

> *In regard to the proposed clause 5.5.6C requiring configuration works (including rerouting of network paths) being published in Annual Planning Reports prior to works being undertaken, VENCorp agrees with the principle of the proposal, but has concerns about the implementation of this Rule Change.*
>
> *VENCorp is concerned about the potential delays to a project associated with the requirement to publish the information in an Annual Planning Report prior to the works being undertaken.*

This requirement could lead to unnecessary delays in relation to works being undertaken for third parties, such as network extensions for connecting parties (eg. generators) or relocation works for road corporations.

VENCorp suggests that notification of reconfiguration could also be made by publishing a notice to stakeholders, similar to the process used for funded augmentations, or through publication in the Annual Planning Report, whichever is the most practical process, given the available time.

Stanwell is somewhat surprised that there would be network projects proposed and then so rapidly undertaken. However, Stanwell has no objection to Vencorp's proposal that, as an alternative to publishing in the Annual Planning Report, the TNSP could use any other sufficiently prominent and effective means of communication.

4 What is the role of connection agreements in resolving the reconfiguration issue and is there an argument for reversing the direction of compensation?

EnergyAustralia has stated that:

Stanwell could seek to negotiate an arrangement whereby Powerlink maintains the existing connection currently enjoyed by Stanwell.

It is important to note that Stanwell has not at any stage requested that Powerlink retain the links it proposes to remove to Kareeya or in any other way "second guess" Powerlink's network planning decisions. On this basis associated comments raised by EnergyAustralia, such as those detailed below, are misguided in the context of the Rule Change put forward by Stanwell:

If anything, the proposed flow of compensation is in the wrong direction. If a reconfiguration is justified under the regulatory test, the TNSP should be compensated <u>to the extent that the TNSP undertakes an alternative option (a non-least cost option) at the request of a market participant.</u>

In EnergyAustralia's view this risk could be mitigated by Stanwell entering into a connection agreement with Powerlink for its existing connections.

However, even if in light of the above clarification, EnergyAustralia maintains the view that connection agreements can fully address the stranding risks of reconfigurations, Stanwell cannot agree.

Stanwell's Rule Change proposal does anticipate the possibility that a connection agreement can sometimes deal with the issue of reconfiguration through providing that compensation is only payable where the connection agreement does not address this issue. As Stanwell has stated previously however, it is not necessarily always possible or appropriate to deal with reconfiguration through connection agreements.

In the case of Kareeya, the only possible opportunity for effective negotiations in respect of reconfiguration would have been prior to the announcement of the reconfiguration and, probably, prior to it building the generation plant in the first place. With the plant built, Stanwell has limited, if any, ability to negotiate while the network service provider's negotiating position would be very strong indeed.

The experience with Kareeya is not unique. The above comment by Stanwell is consistent with the NGF submission that states that such agreements are extremely difficult to negotiate with transmission network operators.

In summary, connections agreements may at least theoretically solve some of the reconfiguration issues that could arise and the proposed Rule Change would not interfere with that possibility. However, in general connections agreements are inadequate to address this issue.

5 What is the difference between compensation and firm access?

ETNOF states that:

> *Furthermore, it is a fundamental principle of the market that access to the transmission network is provided on a non-firm basis; indeed the market provides no firm transmission rights to any participant. Contrary to this principle, the Stanwell proposal provides an implied property right which ETNOF believes would be better and more fully considered as part of the AEMC congestion management review.*

There is, however, an important distinction between Stanwell's proposal and the concept of firm access. Firm access concerns whether, amongst competing users, one should have priority over another and, indeed, that issue is appropriately a "congestion management" issue as the very term suggests.

Stanwell's Rule Change, on the other hand, addresses what happens when a network is moved or removed such that a user has no connection or service at all. It is not a question of competing uses for the network.

In any event, even if the proposal were a form of firm access (which Stanwell considers it is not), just because the Rule Change is linked to a broader issue is no reason for it not to be considered and progressed on its own merits. Indeed that is required by the Rule Change process.

The same applies to the suggestion by EnergyAustralia that consideration of this matter could be postponed when it states:

> *There may be more merit therefore in including network reconfiguration as part of a wider debate on the principles, application and operation of the Regulatory Test.*

6 How can compensation be quantified?

ETNOF expresses that the quantification of compensation would potentially be contentious and that a means to resolve that issue would be for the AER to prepare guidelines for such quantification.

Stanwell's submission anticipated that issue and proposed two potential solutions: either or both of an AER Guideline or a dispute resolution process. From Stanwell's perspective neither is necessarily superior and therefore the supporting submission made the suggestions but left it to the AEMC to decide whether either or both was desirable.

Stanwell has no objection to ETNOF's proposed approach and if it would assist the AEMC, Stanwell would be prepared to supply drafting either alone or, provided ETNOF was willing, drafting settled by both interested parties.

7 Is lost revenue a "cost"?

Implicit in EnergyAustralia's submission (for example in the statement "Stanwell assumes that because it is no longer able to provide System Restart Ancillary Services that this is an obvious cost to be included in the identification of options") is a suggestion that lost generator revenue is not a cost

that can or should be quantified in the Regulatory Test or in respect of which compensation should be made.

There is a wide range of costs and benefits that could potentially be relevant in the context of a reconfiguration just as there currently is with respect to augmentations.

While it is unrealistic to seek to foresee the universe of such costs and benefits for all possible reconfigurations (and indeed expert engineering or economic input may be relevant to the assessment of some costs), the following observations can be made concerning the question as to whether lost anticipated black start revenues to a generator would amount to a cost.

While each reconfiguration would have to be separately considered, generally:

- where a reconfiguration results in a generator losing blackstart revenue, that revenue itself is not generally an economic cost;

- however, there are costs of having constructed the plant or having upgraded it which, if the reconfiguration had not occurred, were expected to be recovered in backstreet revenues. It is these costs that would be relevant to the cost benefit analysis, and

- over-all, it can be expected that the costs will approximate to the revenues because when making the initial construction decision or any upgrade decision, it will have had choices between investing in alternative projects or investing in a smaller project at the site. Similarly, there will have been other investors with investment projects that, absent the construction of the plant concerned, may have proceeded instead. Ordinarily, the marginal revenues contributed by the construction or upgrade of the plant concerned would equal the full economic costs of its construction - if the revenues were less than the costs, the project would not have been pursued and if the revenues significantly exceeded the costs, it is likely that other competing projects would also have been undertaken thus competing away the excess revenues.

Therefore, while a net cost benefit analysis would include only the costs, in the ordinary course these will equal the expected revenues. Indeed if direct actual data concerning the costs are unavailable, it may be possible for an expert to estimate what the likely costs would have been based on the expected revenues.

8 Does the Rule Change merely represent the shifting of stranding risk from generators to networks or to end customers?

A further issue which warrants comment is the question as to whether Stanwell's proposed Rule Change amounts to shifting stranding risk between parties within the market - that is a 'mere' wealth transfer (or merely reversing a wealth transfer).

It is certainly the case that absent the Rule Change generators are at a significant risk of asset stranding when reconfigurations occur and, for the reasons set out in Stanwell's submissions to the Commission, that risk distorts investment decisions both generally discouraging generation investment and particularly discouraging diversely located generation investment. Importantly, generators have little ability to reduce or control that risk.

Indeed applying network planning discipline to reconfigurations and putting in place an optimal reallocation from beneficiaries to those who suffer losses from reconfigurations does transfer the risk (initially to networks and then to end users) but in the process minimises that risk and, to a significant extent, converts it from a stranding risk to a minimal cost.

By shifting that risk from each individual generator to the network it is possible for the network to manage that risk within the network planning process and minimise the over-all risk of the electricity supply chain. The costs that are therefore ultimately passed on to end users are minimised in the long run reducing total costs for end customers.

9 Can and should the Rules provide for the payment of inter-participant compensation?

Three interconnected issues arise in relation to the payment of compensation between market participants: Can the Rules provide for participant compensation? Should the Rules provide for participant compensation? Are there instances where the Rules already provide for compensation?

The *National Electricity Law* provides clear authority for the AEMC to make Rules that deal with the payment of compensation between participants in the market. Inter-participant compensation falls squarely within the principal Rule making power in section 34(1)(a) which provides that the AEMC may make Rules for or with respect to regulating "the operation of the national electricity market." Further, sections 34(1)(b)(c), 34(2) and sections 7,15,16,23,34(a)(c) and 36 of Schedule 1 would provide more specific possible heads of power for the various aspects of the proposed Rule.

More importantly however, Stanwell has demonstrated that the payment of compensation under the Rules provides for optimal policy outcomes through promoting the Market Objective. Stanwell has consistently demonstrated that the proposed Rule promotes the Market Objective through ensuring the costs and benefits of a reconfiguration are appropriately identified and allocated. Identification is achieved by applying the Regulatory Test (or an analogous planning test). Allocation is achieved by a mechanism for compensation. This Rule Change does not interfere with efficient network planning and compensation is only payable where a superior network reconfiguration creates benefits in excess of the costs of abandoning the existing configuration.

This Rule Change is not radical in this respect. The precedent that the Rules can and should in appropriate circumstances provide compensation has already been established.

The payment of compensation between market participants already occurs under the Rules. Clause 4.8.9(a) of the Rules provides:

> "(1) *NEMMCO* may require a *Registered Participant* to do any act or thing if *NEMMCO* is satisfied that it is necessary to do so to maintain or re-establish the *power system* to a *secure operating state*, a *satisfactory operating state*, or a *reliable operating state.*
>
> (2) *NEMMCO* may authorise a person to do any of the things contemplated by section 116 of the *National Electricity Law* if *NEMMCO* is satisfied that it is necessary to do so for reasons of public safety or the security of the electricity system."

Where such a direction is given by NEMMCO, clauses 3.12.11, 3,15.7, 3.15.7A and 3.15.7B of the Rules provide for the payment of compensation by NEMMCO to that directed participant. In the event that compensation is payable, the Rules also provide a mechanism for the recovery of the costs of that compensation from market participants and end-use customers through the pool markets settlement system. The 2005 Statement of Opportunities (**SOO**), published by NEMMCO, contains historical information on NEMMCO directions to market participants including the magnitude of the total amount of compensation paid which shows that NEMMCO directions (supported by compensation where that is provided for) are significant.

Indeed, the purpose and effect of paying compensation to generators who are subject to a NEMMCO direction, as outlined above, is highly analogous to the issue of network reconfiguration that Stanwell

is seeking to address through this Rule Change. NEMMCO directions are designed to ensure individual generators are not forced to bear the cost of events outside their control such that they are forced to increase their prices to prepare for that contingency. Instead, the costs of these uncontrollable events are allocated across the market or "socialised" in an efficient way that minimises prices paid by end-use customers. The compensation mechanism proposed by Stanwell for reconfiguration proceeds on the same basis of efficiently allocating the uncontrollable risk and costs of reconfiguration faced by generators across the market such that end-use customers enjoy the benefit of lower costs.

10 Is the Regulatory Test the appropriate mechanism for the identification of the costs and benefits of a reconfiguration?

The issue has been raised as to the appropriateness of using the Regulatory Test as the mechanism for assessing network reconfigurations.

Stanwell has consistently maintained that what is required, to ensure optimal network planning decisions and promote the Market Objective, is an analysis of the total costs and benefits of a network reconfiguration. In the absence of such analysis, Stanwell has demonstrated the potential for market participants to incur significant cost and revenue losses where such costs and losses remain unaccounted for.

The key requirements in the event of a reconfiguration is for a cost-benefit analysis of the options. Stanwell has proposed applying the existing Regulatory Test to reconfigurations on the basis that the Regulatory Test is the very tool that currently exists in the Rules to assess the costs and benefits of proposed network augmentations.

As discussed in our letter of 10 July 2006, to the extent that the Regulatory Test is applied differently on the basis of whether an augmentation is a reliability based augmentation or not, network reconfigurations can similarly be categorised as reliability initiatives or otherwise.

Nonetheless, should the Commission be of the view that the Regulatory Test, as it currently operates with respect to augmentations, is not the appropriate test to apply in the case of reconfigurations Stanwell would be most happy to work with the Commission to develop a specific analogous planning test for reconfigurations that provides for an analysis of the total costs and benefits of the reconfiguration.

11 Summary

Stanwell has identified a policy flaw in the Rules and, rather than simply addressing its own interests, has proposed a principled solution that will enable optimal network planning, avoid generator assets becoming stranded and reduce investment risks where these are all in the long run interests of end-use consumers of energy.

Stanwell's accompanying submission provides a detailed analysis of why the proposal furthers the Market Objective.

In response, there has been no outright opposition and no statement that any aspect of the Rule proposal would be contrary to the Market Objective. Indeed in important respects all the submissions received provide support for different aspects of Stanwell's Rule proposal.

The submissions that are not wholly supportive raise points of detail which, as explained above, are either misguided or can be easily addressed.

Overall the submissions received by the AEMC strongly reaffirm that reform in this area is warranted and that the solution proposed by Stanwell is, perhaps with little amendment, appropriate and effective.

Attachment B: Proposed Rule Change – incorporating *Draft National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006* (Draft 2)

In Chapter 10

insert *network reconfiguration*

Works, which are not a *new large transmission network asset or small transmission network asset* to:

(a) permanently re-route the path of the *network;* or

(b) modify the technical capabilities or usability for *Network Users* of all or parts of the *network*;

in relation to which the *Transmission Network Service Provider*:

(c) estimates it will be required to invest a total capitalised expenditure in excess of $10 million; or

(d) has been advised by a *market participant* that it will incur a cost and/or forgo revenue in excess of $1 million.

In Chapter 10

insert subclause 4 into *affected participant*

(4) In Clause 5.6.6C, a *market participant* who has informed the *Transmission Network Service Provider* within 60 business days of a publication pursuant to clause 5.6.6C that the *market participant* will incur a cost, or loss of revenue, in excess of $1 million as a result of a proposed *network reconfiguration*.

In Chapter 5

insert clause 5.6.6C

(a) Prior to undertaking a *network reconfiguration* a T*ransmission Network Service Provider* must *publish* in the *Annual Planning Report*:

(i) the month and year in which the proposed *network reconfiguration* will become operational;

(ii) the purpose of the *network reconfiguration*;

(iii) the total cost of the proposed *network reconfiguration*;

(iv) other reasonable *network* and *non-network* options to the *network reconfiguration*. Other reasonable *network* and *non-network* options include, but are not limited to, *interconnections, generation* options, demand side options, *market network service* options; options involving other *transmission* and *distribution networks* and options which involve maintaining the existing configuration of *network*;

(v) an explanation of the ranking of reasonable alternatives to the project including *non-network* alternatives. This ranking must be undertaken by the *Transmission Network Service Provider* in accordance with the principles contained in the *regulatory test;* and

(vi) whether the proposed solution will have a *material inter-network impact.* In assessing whether a *network reconfiguration* will have a material inter-network impact *a Transmission Network Service Provider* must have regard to the objective set of criteria *published* by the *Inter-regional Planning Committee* in accordance with clause 5.6.3(i) (if any such criteria have been *published* by the *Inter-Regional Planning Committee*).

(b) The *Transmission Network Service Provider* must consult with *affected participants* and provide a reasonable opportunity for *affected participants* to make written submissions in relation to the proposed *network reconfiguration.*

(c) At the conclusion of the consultation process in clause 5.6.6C(a) and (b) and before undertaking the *network reconfiguration*:

(i) the *Transmission Network Service Provider* must consider the matters raised in the comments and written submissions of *affected participants* and make appropriate amendments;

(ii) if there is any material change in the proposed *network reconfiguration* as a result of the consultation process, *the Transmission Network Service provider* must provide a further notification of the details referred to in clause 5.6.6C(a) to *affected participants*, in relation to the proposed *network reconfiguration,* incorporating the agreed or amended matters; and

(iii) the *AER* must take into account the matters raised in the consultation process in its determination of the *Transmission Network Service Provider's revenue cap* and its determination of whether the *network reconfiguration* the subject of the consultation satisfies the *regulatory test.*

In Chapter 5

insert clause 5.3.4B

Compensation for *network reconfiguration*

(a) Unless a *connection agreement* otherwise provides for the relationship between the parties to it in respect of a *network reconfiguration*, compensation will be payable by a *Transmission Network Service Provider* to an *affected participant*, in the amount and at the time, the *affected participant* incurs an additional cost or forgoes revenue (net of any direct costs in earning that revenue) as a result of a *network reconfiguration* by the *Transmission Network Service Provider*;

(b) Where a *connection agreement* provides that compensation is payable by a *Transmission Network Service Provider* to a *market participant* as a result of a *network reconfiguration,* the terms of and rate of compensation payable by the *Transmission Network Service Provider* must be reasonable.

[Drafting Note: The above clause 5.3.4B(b) could alternatively sit in 5.3.6 or clause 5.3.7.]

In Chapter 6

insert clause 6A.19.2(a)(9)

(9) costs of compensation which are payable by a *Transmission Network Service Provider* pursuant to Clause 5.3.4B or a *connection agreement* must be allocated to *prescribed transmission services*.

In Chapter 6

insert subclause (xiii) into Clause 6A.6.7(b)(3)

(xiii) reasonable estimates as to any compensation likely to be payable by the *Transmission Network Service Provider* to a *market participant* as a result of a *network reconfiguration.*

In Chapter 10

insert clause (e) into *Pass through event*

Pass through event -

Any one of the following events:

(a) an Insurance Event;

(b) a *Service Standard Event;*

(c) a *Tax Change Event;*

(d) a *Terrorism Event;* or

(e) a *Network Reconfiguration Compensation Event.*

In Chapter 10

insert *network reconfiguration event*

An occurrence which:

(a) requires a *Transmission Network Service Provider* to provide compensation to a *market participant* as a result of a *network reconfiguration*;

(b) results in the *Transmission Network Service Provider* incurring *materially* higher costs in providing *prescribed transmission services* than it would have incurred but for that occurrence; and

(c) allowance was not made in the *revenue cap* determination for the cost of the compensation.