

Congestion Management Program – Statement of Approach¹

December 2006

The effective management of congestion is critical to the efficient operation of the National Electricity Market (NEM). Congestion occurs when electricity demand cannot be met using the lowest priced combination of generation available due to transmission capacity or power system security limitations. It would not be efficient to eliminate all transmission congestion, because of the likely cost of doing so compared with the benefits. This means that some congestion, and its management, is inevitable.

Congestion management is necessary to maintain the physical and operational security of the power system and has important implications for spot prices, the degree of competition, the bidding incentives for market participants, and the level of price and volume risk borne by participants. In the long-term, the manner in which congestion is managed affects the investment decisions of new generators, load, network service providers, and the opportunities for alternative energy sources.

The Commission has before it one Ministerial Council on Energy (MCE) reference for Review (Congestion Management Review), and three National Electricity Rule (Rule) change proposals that relate to various aspects of how network congestion is managed in the NEM.² The Commission has recently determined two further Rule change proposals related to congestion matters³. It is essential that this work is co-ordinated by the Commission to deliver a comprehensive “Congestion Management Regime” for the market going forward. Predictability in respect of the general direction of the development of the regulatory framework, and confidence that any necessary transitions will be managed, is also essential to those investing in electricity infrastructure.

The Commission issued a Statement of Approach in June 2006 with the intention of providing information and clarity about the way in which the Commission proposed to deal with the Rule change proposals and the Congestion Management Review in an integrated manner. This updated Statement is to advise of progress to date, changes to timelines for some elements of the program and the Commission’s plans for completing this work.

The Commission considers that the integrated “Congestion Management Regime” includes all the elements currently under consideration, such as identifying congestion, managing congestion, and setting out appropriate processes for assessing and determining a region boundary change. The “Congestion Management Regime” should be in place for the longer-term, incorporating mechanisms necessary to address network congestion in the short-to-medium term. While the details of these future arrangements are yet to be finally determined, it appears to the Commission that any comprehensive “Congestion Management Regime” is likely to include:

- Information disclosure to the market, such as the NEM Management Company’s (NEMMCO’s) current Statement of Opportunities (SOO)/ Annual National Transmission Statement (ANTS) process;
- Incentives to address congestion, such as investment in transmission and generation, and demand-side alternatives;

¹ This Statement supersedes and replaces the Statement of Approach issued by the Commission on 6 June 2006

² These matters are: the MCE-directed Congestion Management Review; MCE Reform of Regional Boundaries Rule change proposal; Snowy Hydro Ltd Review of the Snowy Regional Boundary Rule change proposal; and Macquarie Generation Review of the Snowy Regional Boundary Rule change proposal.

³ Final Rule determination and Final Rule on the Management of Negative Settlement Residues in the Snowy region and the final Rule determination on the Management of Negative Settlement Residues by Re-orientation.

- Intervention mechanisms such as those relating to price determination, energy dispatch, and /or planner of last resort powers in respect of transmission investment; and
- The potential and process (which itself is clear and stable) for longer-term structural change through the alteration of regional boundaries if this is found to be necessary and appropriate.

The Congestion Management Review, proposed Rule for a revised boundary change process, reform of principles for the Regulatory Test, and the introduction of a last resort planning mechanism have been referred to the Commission by the MCE. These relate to the NEM wide regulatory framework for congestion management and boundary change in the longer term. The Commission published its draft Rule determination and draft Rule on the Last Resort Planning Power Rule change proposal on 23 November 2006. It also published its final Rule determination and commenced the final Rule on the Economic Regulation of Transmission Services on 16 November 2006. In addition, on 30 November 2006, the Commission published its final Rule determination and commenced the final Rule on the Reform of Regulatory Test Principles. Two market participant proposals to change the Snowy region boundary as a long-term means of addressing existing material congestion in that area, are also before the Commission for its consideration.

These Rule change proposals, the Last Resort Planning Power draft Rule determination and draft Rule, the Economic Regulation of Transmission Services final Rule determination and final Rule, the Reform of Regulatory Test Principles final Rule determination and final Rule, the Congestion Management Review issues paper, and stakeholder submissions on the matters, are available on the Commission's website (www.aemc.gov.au).

On 17 October 2006, the Commission held an Industry Leaders Strategy Forum to obtain views and opinions from industry leaders on a range of congestion related issues. The Background Paper for the Forum, Agenda, and Summary Notes are also available on the website.

The Commission is bound by the NEM Objective when making decisions on these matters, requiring the promotion of efficient investment in, and use of electricity services for the long-term interests of consumers, with respect to price, quality of supply reliability, and system security. When considering congestion and region boundary related proposals, the Commission will have regard to a range of matters and in particular, the impact of the proposals on: dispatch efficiency; facilitation of trading in the NEM, including inter-regional trading and associated risk management; and the promotion of good regulatory practice, including sound regulatory principles regarding the design of the NEM and the National Electricity Rules.

The Commission considers that the issues of congestion management and boundary location in the Snowy region are of more immediate significance than those that currently may arise elsewhere in the NEM, principally because the region sits between the two largest regions in the NEM (measured by MW and MWhs) and because of the particular circumstance that a network loop traverses two region boundaries. The Commission notes that there are "legacy" issues associated with congestion management in and around the Snowy regional boundary that give these matters a priority in the consideration of congestion management and boundary issues in the NEM as a whole. The Commission notes that this view was widely reflected in the submissions received in response to the Congestion Management Review issues paper, consultation for the Rule proposal on managing negative settlement residues in the Snowy region, and first round consultation on the two Snowy region boundary Rule change proposals.

The current Snowy trial of Constraint Support Pricing/Constraint Support Contracts (CSP/CSC) arrangements (Snowy CSP/CSC Trial) is providing an opportunity to assess one option for congestion management, which is not currently part of the permanent design framework of the NEM.

The Commission has considered two alternative Rule change proposals (Southern Generators and NEMMCO's, transferred to the Commission from the National Electricity Code Administrator on 1 July 2005, and Snowy Hydro and NEMMCO's received on 24 May 2006) that sought to modify the trial to address the issue of negative settlement residues in the Snowy region. The Commission published final Rule determinations on these alternative proposals, accepting the Southern Generators' proposal and rejecting the Snowy Hydro proposal. The Southern Generators Rule commenced on 1 November 2006.

The derogation in Part 8 of Chapter 8A of the Rules (Part 8 Derogation), which implements the Snowy trial, will cease to apply on: (1) 31 July 2007; (2) the implementation of the first region boundary review by the AEMC; or (3) as otherwise determined by the AEMC. NEMMCO has advised the Commission that if the Commission determined to make any of the Rules proposed for a change to the Snowy boundary, implementation of that decision would not be practicable before 1 November 2007 at the earliest. This advice was based on the Commission publishing a draft Rule determination on those boundary change proposals on 15 December 2006 and a final Rule determination in March 2007. That is, the derogation could expire before an alternative congestion mechanism can be put in place.

On 19 October 2006, the Commission issued an Information Disclosure Statement regarding the expiry of the Part 8 Derogation. This Derogation is a NEMMCO participant derogation that relates to Network Constraint Formulation. It has three functions: (1) clarifies NEMMCO's authority to use fully co-optimised network constraint formulations; (2) allows NEMMCO to manage counter-priced inter-regional flows using alternative constraint formulations; and (3) implements the Partial Constraint Support Payment/Constraint Support Contract (CSP/CSC) Trial in the Snowy region.

The Commission advised in that statement that:

"Expiry of the derogation with no transitional measures in place would introduce unnecessary uncertainty and risk into the market. While the Commission does not wish to pre-empt its decision on the Snowy region boundary Rule change proposals, it recognises the importance of clear transitional arrangements in order to avoid participant dislocation and disruption to the market. As indicated in the Statement of Approach, one possible transitional arrangement is the extension of the derogation until the implementation of a region boundary change, if that is the outcome of the Commission's Draft Rule Determination."⁴

The Congestion Management Review and MCE Rule proposals go to the enduring design of the NEM across all regions. The Commission is currently of the view that any Rules it makes for the short- and medium-term management of congestion and boundary change in the Snowy region should be consistent with the long-term NEM wide framework. Consequently, the Commission intends to co-ordinate its decision making in respect of all of these related matters.

The Commission's assessment of these matters has been extended due to the diversity and complexity of the issues, the need to consider further issues identified by the Industry Leaders Strategy Forum, and in subsequent submissions, and the implications of the recent changes to the Snowy CSP/CSC Trial. The Commission also notes that the Energy Reform Implementation Groups has made a number of observations regarding congestion management in its draft report and intends to take those observations into account. Accordingly, the Commission has modified its work program⁵. The Commission has, however, undertaken considerable work in other congestion related areas including the Rules for transmission revenue and price regulation, the last

⁴ Australian Energy Market Commission, Information Disclosure Statement - Expiry of the Part 8 of Chapter 8A of the National Electricity Rules, 19 October 2006, available: www.aemc.gov.au.

⁵ The Commission has written to the MCE requesting approval of an extension to the current timetable.

resort planning mechanism, and the reform of Regulatory Test principles, on which the Commission issued its final Rule determination on 30 November 2006.

The Commission has also decided to release separate determinations on the Snowy Hydro and Macquarie Generation proposals for changes to the Snowy Region boundary with the former scheduled for release in late January 2007 and the latter in March 2007. This approach has been adopted because the Commission's analysis of the Snowy Hydro proposal is well advanced and can be ready for decision earlier than the more analytically complex Macquarie Generation proposal. The Commission considers it will be beneficial to undertake early consultation on that matter, pending release of the Macquarie Generation draft decision.

The Commission's plan now includes the publication of the following package of draft Rule determinations and decisions:

- Draft Rule determination on the Snowy Hydro proposal to change the Snowy Region boundary to be released in late January 2007 (the specific date will be formally gazetted);
- Draft Rule determination on the Macquarie Generation proposal to change the Snowy Region boundary in early April 2007;
- Draft determination on the expiry of the Derogation in Part 8 of Chapter 8A of the Rules by 22 December 2006;
- Directions Paper on the Congestion Management Review to be released in early February 2007;
- Draft Report of the Congestion Management Review to be released in June 2007; and
- Draft Determination on the MCE Region Boundary Criteria Rule Change proposal to be released in June 2007 to accompany the Draft Report on Congestion Management.

By the end of April 2007, the Commission will release its final Rule determination on the Snowy Hydro region boundary change proposal. By the end of May 2007, it will release the final Rule determination on the Macquarie Generation proposal.

The diagram below shows the Commission's updated approach to its congestion management program.

The Commission considers that it is important for stakeholders to be well informed about the process the Commission will adopt in finalising these inter-related proposals. This updated Statement of Approach reflects the Commission's commitment to: adopt an open process; be clear about its analytical approach; manage related matters in a co-ordinated and integrated manner; and provide interested stakeholders with the earliest opportunities to understand and respond to issues.

Australian Energy Market Commission

7 December 2006

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