

23 March 2006

Dr. John Tamblyn
Chairman
Australian Energy Market Commission
Level 16, 1 Margaret Street
SYDNEY NSW 2000

Dear Dr. Tamblyn,

National Electricity Amendment (Snowy Region Boundary) Rule 2006

National Electricity Amendment (Alternative Snowy Region Boundary) Rule 2006

The materiality of the problems arising from the Snowy intra-regional constraint certainly justifies an assessment of a regional boundary change and Delta Electricity is pleased to provide comment on the proposals from Snowy Hydro and Macquarie Generation. It is Delta's view that the most important aspect of the review will be comprehensively identifying and quantifying the economic costs and benefits of each proposal to ensure the final determination delivers an outcome with a clear net economic benefit.

Boundary Review Assessment

Both boundary change proposals acknowledge the same problem of a misaligned Snowy region in the NEM but differ in the proposed solution to the problem. Both proposals also indirectly recognise the limitations of the CSP/CSC regime and that the Tumut-Murray constraint cannot be addressed by investment.

Snowy Hydro's proposal outlines three options for a boundary change in the Snowy region. While Snowy Hydro stated that the most viable option is for a rule change to redefine Tumut and Murray nodes into NSW and VIC region respectively, there is no detailed economic cost benefit analysis to support the case. Snowy Hydro's proposal may remove the impact of loop flows and provide transparent pricing signals for new investment but the value of these



benefits are not quantified. More importantly there is no detailed analysis or quantification of competition benefits.

Macquarie Generation's proposal to create a new Southern NSW region and a Northern VIC region is one of the three options in Snowy Hydro proposal and has regional boundaries located at transmission pinch points. Whilst the proposal in principle is sound an assessment of the economic cost and benefits would need to be determined to understand how this proposal compares to the Snowy proposal.

The Murray-Tumut constraint has long been recognised as material and problematic point of congestion. There have been attempts at resolving the problems and it is noteworthy that within just a few months into the two year CSP/CSC trial, and in the absence of any thorough analysis of its effectiveness, Snowy Hydro is now suggesting the abolishment of the Snowy region. It would be preferable to achieve a robust long term solution rather than a 'band-aid' solution.

Scope of Assessment

The Snowy boundary change also relates to other rule change proposals currently with the Commission:

- Management of negative settlement residues in the Snowy Region (Lymmco' s Proposal).
- Congestion management.
- Region boundary principles.

Considering all these proposals together presents considerable conceptual and analytical difficulties however the Snowy regional boundary review provides an opportunity to use the Snowy boundary change proposals as a 'test case' for developing criteria for congestion management and regional boundaries.

In Delta's view, the assessment of the Snowy regional boundary proposals should take account of:

- MCE's statement on NEM Electricity Transmission - regional structure, consistent option 4 constraint equation formulation, interim measure of the current arrangement to manage the negative settlement residue, and efficient financial trading arrangements.
- The NEM objective to promote both efficient investment in and efficient use of electricity services for the long term interests of consumers.
- Market data that is readily available to analyse the effectiveness of all measures that were implemented for the Snowy region such as option 4 constraint formulation, interim measure for negative settlement residue and the CSC/CSP trial. The experience and lessons learnt



from all these measures will provide valuable input to finding a long term solution.

The NEM objective aims to strike a balance between short term productive, allocative and longer term dynamic efficiency in the NEM. It is noted that most analysis related to the Snowy region focused on the short term productive efficiency with nodal spot pricing used as a benchmark for the most efficient outcome. There is a fundamental flaw in this approach as it does not consider the impact of bilateral contracting, risk hedging instruments, SRA market for inter-regional contracting and the nexus between the spot market and contract market.

The MCE statement and the NEM objective reinforce the importance of a thorough cost benefit analyses on all options for the Snowy region boundary.

Counter Price Flows and Loop Flow

Counter-price flows may occur when an option 4 constraint equation is binding and will result in negative settlements residues. Counter-price flows diminish the value in the settlement residue that is fundamental for supporting inter-regional competition in the contract market. It is important for the current negative settlement residue management arrangements to be maintained until a more viable solution is accepted by the industry.

Not all binding option 4 constraints will produce counter price flows. Generally, counter price flow may occur under the following conditions;

- Loop flow (with a generator or a RRN in the loop); and
- Aggregated capacity of local remote generators is larger than the transmission capacity to the RRN. An example is Tarong constraint prior to the Blackwall to Brisbane and Millmerran to Middle Ridge upgrade. There are currently no other locations in the NEM under system normal condition with this situation.

The AEMC needs to consider these issues in this boundary review and ensure the changed region does not have a generator or a RRN in the loop.

Delta will provide more detailed comments and a proposal on counter price flow, loop flow and option 4 operations in response to the consultation on congestion management.

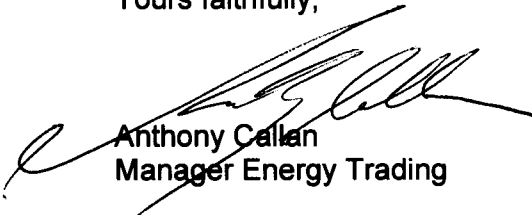


Summary

The two Snowy regional boundary change proposals before the AEMC need to be assessed on sound economic principles. This review provides an opportunity to establish the principles and criteria for this and future regional boundary change reviews.

If you require further clarification of Delta's views on this matter please do not hesitate to contact me on (02) 9285 2712.

Yours faithfully,



Anthony Callan
Manager Energy Trading