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Chairman

Australian Energy Market Commission
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Dear Dr Tamblyn

National Electricity Rules: Rule Change Application

Rules to establish a comprehensive inter-participant framework for addressing network replacement or reconfiguration

We refer to our rule change application, dated 17 May 2006, (**rule change application**) requesting the Australian Energy Market Commission (**AEMC**) make rules to establish a comprehensive inter-participant framework for addressing network replacements or reconfigurations.

We request that this rule change application be handled as a matter to be expedited pursuant to section 96 of the *National Electricity Law* on the basis that this rule change must be made urgently.

This letter summarises the key aspects of rule change application focussing in particular on why this rule change is required urgently. The letter also demonstrates that, as well as being urgent, the rule change is non-controversial and should be expedited on that basis as well.

In summary, this letter makes the following key points:

- The rule change should be treated as urgent as:
 - Stanwell's Kareeya power station is likely to be directly impacted in the near term by a network reconfiguration that has been foreshadowed by Powerlink such that Stanwell, Powerlink and ultimately end use customers currently face uncertainty as to how the costs and benefits or reconfigurations are allocated.
- In any event, the rule change should be treated as non-controversial as:

- The proposed *regulatory test* and consultation process is limited in scope and does not impose an unreasonable burden on TNSPs;
- Any cost imposed on TNSPs by the rule change is recoverable through the revenue cap and/or "positive pass through" mechanism; and
- The rule change promotes the National Electricity Market Objective (**NEM Objective**)¹ with customers benefiting from the lower electricity costs where risks in the electricity supply chain are reduced.

1 Summary of rule change application

Stanwell's application is intended to address a current gap or failure in the National Electricity Rules (the **Rules**). Whilst the Rules currently require a that a *Transmission Network Service Provider (TNSP)* must conduct a *regulatory test* and consultation program when building a *new large transmission asset or new small transmission asset*,² where such assets constitute an *augmentation* of the network, the Rules impose no such explicit requirement in the case where a TNSP replaces or reconfigures network components and assets.³

The effect of this gap in the rules is that it is not clear what rights and obligations exist as between TNSPs and network users in the situation when a TNSP proposes a network replacement or reconfiguration. This is a considerable concern to Stanwell as network replacements or reconfigurations potentially have significant impact on network users. Wherever rights and obligations are unclear there is also the potential for wasteful disputation.

Furthermore, as already explained in the rule change application, the uncertainty created by this failing of or gap in the rules undermines the NEM Objective. The uncertainty increases the riskiness of establishing and maintaining generation facilities and therefore acts as a disincentive to efficient investment, potentially increasing the cost of electricity and undermining reliability and security of supply.

Stanwell recognises the need for efficient replacement and reconfiguration of network assets. Stanwell does however believe that the impacts of network replacement or reconfigurations on network users, who have reasonably relied on the existing configuration of the network in making their investment decisions, must be taken into account. Further, in deciding whether to replace like-for-like or reconfigure the network, and in deciding what form the reconfiguration should take, there is a need to ensure that this decision is based on obtaining optimal investment, end-line customer costs, reliability and security of supply.

For these reasons, Stanwell's rule change application called for the following:

¹ Section 7 of the *National Electricity Law* provides that: "The national electricity market objective is to promote efficient investment in, and efficient use of, electricity services for both 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."

² Rule 5.6.6 of the Rules sets out the consultation and reporting requirements that must be satisfied when a *new large transmission network asset* is to be established. Rule 5.6.6A similarly sets out the consultation and reporting requirements that must be satisfied where a *new small transmission network asset* is to be established.

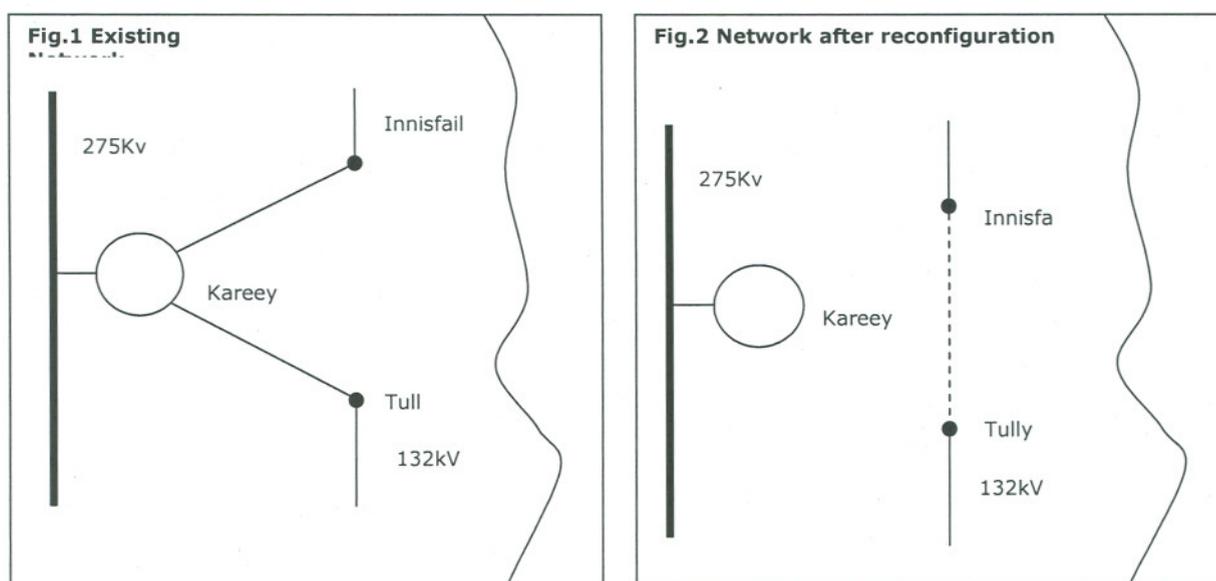
³ When talking of a network replacement or reconfiguration, Stanwell is referring to works undertaken by a TNSP to replace components or reconfigure sections of the network, where such works do not necessarily constitute an *augmentation*, or increase in capacity, of the network.

- 1) that the *regulatory test* must be undertaken not only in the context of augmentation of the network but also where there is a network replacement or reconfiguration;
- 2) that unless the network users and the TNSP have agreed otherwise, that compensation be payable to network users where they incur cost or forgo revenue as a result of a network replacement or reconfiguration; and
- 3) that there be a mechanism which allows TNSPs to recoup the cost of the compensation payable as a result of network replacement or reconfiguration via the TNSP revenue cap calculation and in period via a “positive pass through” mechanism.

2 The rule change is required urgently

Stanwell considers this rule change is urgent as Stanwell has an existing generation asset that in the very near term will be subject to a significant adverse impact as a result of a foreshadowed network reconfiguration.

Stanwell operates the Kareeya Power Station, an 88MW hydro plant south-west of Cairns (and west of Tully). As set out in the Fig.1, Kareeya is connected into a shared network with three lines radiating from the station: to Chalumbin inland, to Innisfail to the north-east and to Tully in the south-east. The lines to Innisfail and Tully are reaching the end of their useable life.



Powerlink has expressed an intention to undertake a network replacement project which entails purchase of an easement and construction of a line between Tully and Innisfail, and dismantling of the Kareeya Innisfail line. Stanwell reasonably expects that because the supply north into Innisfail will be satisfied by the new line, the Kareeya-Tully line will become redundant and will not be replaced when it reaches its useful life. This will mean that Stanwell will ultimately be disconnected from the coastal 132kV network leaving it reliant on the single inland network connection (see Fig. 2). Most importantly however, the dismantling of the Kareeya-Tully line will have significant revenue implications for Stanwell where it will prevent Kareeya from providing system restart services, which it currently has the capacity to do.

Where the Rules do not currently explicitly state the obligations of Powerlink in relation to whether they must undertake a *regulatory test*, and consider the impact of the of the Tully-Innisfail reconfiguration on Kareeya and Stanwell, there is a significant risk that Stanwell will be adversely affected without adequate compensation and that the network replacement or reconfiguration will go ahead even if it does not promote NEM objectives.

Similarly, there is no explicit ability for Powerlink to recover to the costs of any compensation payable to Stanwell.

Flowing from this absence of a clear framework, Stanwell, Powerlink, end use customers and other participants face risks as to how the costs and benefits of the reconfiguration are assessed and allocated. There is also potentially waste in agitating and settling these issues. It is also important that clarity is provided early to who has access to the network such that they can provide system-restart services for the benefit of all participants in the event a system-wide failure occurs. This, particularly the loss of system-restart capabilities in the market and the stability this provides, raises questions about ongoing price, reliability and security of supply which invariably will negatively impact on both efficient use and efficient investment patterns in the market.

Through expediting the introduction of this Rule change so as to ensure that this Rule change covers the proposed Powerlink conduct, the AEMC will remove the uncertainty in relation to the obligations of Powerlink, ensuring that Stanwell's interests and reasonable expectations are not ignored, that uncertainty in the market is minimised and that the NEM objectives are promoted by any network changes.

3 The rule change application is non-controversial

In any event, Stanwell also contends that the rule change should be expedited on the basis that it is a non-controversial rule change. It is non-controversial for the following reasons:

- 1) The proposed *regulatory test* and consultation process is limited in scope and does not impose an unreasonable burden on TNSPs;
- 2) Any costs imposed on TNSPs as a result of the rule change are recoverable through the revenue cap and/or "positive pass through" mechanism; and
- 3) The rule change promotes the National Electricity Market Objective with customers benefiting from the lower electricity costs where risks in the electricity supply chain are reduced.

3.1 The proposed *regulatory test* and consultation process is limited in scope and does not impose an unreasonable burden on TNSPs

The *regulatory test* and consultation process proposed for a replacement or reconfiguration is limited both in magnitude and scope. It is less than that required when establishing a *new large transmission network asset* or *new small transmission network asset* and therefore cannot be said to impose an unreasonable compliance burden on TNSPs. Whilst Stanwell proposes that the *regulatory test* be undertaken, there is no coupled requirement to undertake the comparatively wide consultation⁴ and reporting

⁴ Clause 5.6.6(b) of the Rules requires that an applicant who proposes a *new large transmission network asset* must consult with all *Registered Participants, NEMMCO and interested parties*. Rule 5.6.6A(a) provides that an application who proposes a *new small transmission network asset* must consult will all *interested parties*.

programs⁵ that the Rules require when establishing a *new large transmission network asset* or *new small transmission network asset*.

In relation to the required contents of the *regulatory test* and consultation material, Draft Rule 5.6.6C⁶ provides that the TNSPs need only provide a *notification report* with certain specified information, where the quantity of required information is significantly less than the level of information required in the case of proposed *new large transmission network asset* or *new small transmission network asset*.

Similarly, the consultation process required of a TNSP under the proposed rule change is considerably constrained. Draft Rule 5.6.6C only requires that the TNSP notify and consult with *affected participants* in relation to the network replacement or reconfiguration. *Affected participants* for this purpose are limited to those *market participants* which the TNSP reasonably apprehends will incur a cost, or loss or revenue, in excess of \$1 million as a result of the proposed network replacement or reconfiguration.

Furthermore network replacement or reconfigurations occur infrequently, and as such the *regulatory test* and consultation process required to be undertaken would also be infrequent.

3.2 Any cost imposed on TNSPs by the rule change is recoverable through the revenue cap and/or “positive pass through” mechanism

Whilst Stanwell’s proposed rule change includes a provision for the payment of compensation by TNSPs to *affected participants* of a network replacement or reconfiguration,⁷ TNSPs are able to recoup the cost of any compensation payable via the revenue cap mechanism⁸ or through a “positive pass through” mechanism.⁹ The compensation payable is therefore cost neutral to the TNSP.

Stanwell anticipates that there would be no difficulty in efficiently quantifying the compensation payable under the proposed Rule. However in the event the AEMC considers it appropriate, the AEMC could specify a dispute resolution mechanism to enable any disputes about the quantification of compensation to be settled expeditiously. This dispute resolution mechanism may either be a mechanism specifically designed for this issue, or could simply adopt the proposed Chapter 6 or existing Chapter 8 dispute resolution processes.

Furthermore, draft Clause 5.3.4B provides that TNSPs and network users can address the issue of compensation in their *connection agreements*. As a further element of protection for TNSPs who may be required to pay compensation, even where a *connection agreement* provides that compensation is payable in the event of a replacement or reconfiguration, any compensation payable will be limited to what is reasonable.

Stanwell notes the rule change, at first glance, could be observed as shifting the costs of replacement or reconfiguration to network users in the short term. However, without the Rule Change, Stanwell notes that that the costs incurred by network users for energy are

⁵ See Rule 5.6.6 of the Rules sets out the consultation and reporting requirements that must be satisfied when a *new large transmission network asset* is to be established. Rule 5.6.6A similarly sets out the consultation and reporting requirements that must be satisfied where a *new small transmission network asset* is to be established.

⁶ See Attachment B of rule change application.

⁷ See Attachment B of rule change application - Draft clause 5.3.4B.

⁸ See Attachment B of rule change application - Draft schedule 6.2(3).

⁹ See Attachment B of rule change application - Draft clause (f) in definition of “Pass through event” in Chapter 10 and the draft definition for *network replacement or reconfiguration event* proposed for Chapter 10.

expected to be higher in the long run. Without the rule change, it is likely that individual generators will have to bear significant costs as a result of a network replacement or reconfiguration. Flowing from this and the uncertainty this provides in terms of investment in generation facilities, the long term cost of energy for network users is expected to increase. This is on the basis that prices will increase as generators, who lack certainty in relation to the certainty, will require a higher rate of return on their investment. This will invariably be passed on in the long term via higher energy prices for network users.

3.3 The rule change promotes the NEM Objective

The rule change is non-controversial as it promotes the NEM Objective. The rule change application outlines in detail the reasons as to why the proposed rule promotes the NEM Objective. In summary however, the proposed rules promote the NEM Objective through:

- ensuring that the impact and costs of network replacement and reconfiguration on network users is accounted for such that it promotes efficient network planning decisions;
- providing a greater degree of certainty for network users, particularly generators, such that efficient investment is not discouraged;
- promoting reliability such that security of supply is enhanced on the basis that network users will not be deterred from investing;
- enhancing the efficiency of market related decisions by investors in generation and increasing the willingness of investors to commit capital to the National Electricity Market;
- still allowing for TNSPs to configure their networks in the most efficient way; and
- providing end users with the benefit of cost savings.

4 Conclusion

In conclusion, Stanwell's rule change application to establish a comprehensive inter-participant framework for addressing network replacements or reconfigurations should be expedited as an urgent on the basis that:

- Stanwell's Kareeya power station is likely to be directly impacted in the near term by a network replacement/reconfiguration that has been foreshadowed by Powerlink such that Stanwell, Powerlink and ultimately end use customers currently face uncertainty as to how the costs and benefits or reconfigurations are allocated.

In any event, as well as being urgent, Stanwell's rule change application should also be expedited on the basis that it is non-controversial as:

- The proposed *regulatory test* and consultation process is limited in scope and does not impose an unreasonable burden on TNSPs;
- Any cost imposed on TNSPs by the rule change is recoverable through the revenue cap and/or "positive pass through" mechanism; and
- The rule change promotes the NEM Objective.

Should you have any questions, please contact Denis Warburton on (07) 3335 3846.

Yours faithfully



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