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21 February 2006

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

Dear Dr Tamblyn,

Reform of the Regulatory Test Principles – Ministerial Council on Energy Rule Change Proposal

Stanwell Corporation Limited (Stanwell) welcomes the opportunity to comment on the Rule change proposal submitted by the Ministerial Council on Energy (MCE) on the Transmission Regulatory Test, which is being undertaken by the Australian Energy Market Commission (AEMC). In response the proposal, Stanwell provides the attached submission.

Stanwell looks forward to maintaining on-going consultation with the AEMC during the Rule change consultation process and welcomes further questions regarding the issues raised in our submission.

Yours faithfully

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STANWELL
CORPORATION LIMITED

REFORM OF THE REGULATORY TEST PRINCIPLES

MINISTERIAL COUNCIL ON ENERGY RULE CHANGE PROPOSAL

A REPONSE PREPARED BY STANWELL CORPORATION LIMITED

TO

THE AUSTRALIAN ENERGY MARKET COMMISSION

21 FEBRUARY 2006

1. Introduction

Stanwell Corporation Limited (Stanwell) welcomes the opportunity to comment on the Rule change proposal submitted by the Ministerial Council on Energy (MCE) on the Transmission Regulatory Test to the Australian Energy Market Commission (AEMC). Stanwell has made a separate submission to the consultation on a specific issue relating to replacement of existing transmission. This submission is of a more general nature.

As background, Stanwell is a Queensland Government-owned corporation, with an energy portfolio comprising coal, hydro, wind, and bioenergy generation facilities throughout Australia and generates more than 20 per cent of Queensland's electricity requirements. Our major asset is Stanwell Power Station—a 1,400 MW coal-fired facility located near Rockhampton in Central Queensland. In addition, Stanwell has a dedicated renewable energy portfolio, with hydro power stations and wind farms in Far North Queensland, South East Queensland, Victoria and a new development in Western Australia.

Stanwell supports the intent of the proposed Rule changes – namely to bring more certainty to the operation of the Regulatory Test by defining the role of the Australian Energy Regulator (AER) more clearly. Stanwell strongly supports the retention of the two limbs of the test, namely Reliability and Market Benefits. Although system reliability is critical for customer supply, it is also important for generators to have dependable access to the market. Stanwell supports the use of reliability criteria[1] rather than an economic benefits approach based around VoLL and lost customer supply. The remainder of this submission focuses on the Market Benefits limb of the test.

2. The Market Benefits test and transmission in the NEM

The original purpose of the National Electricity Market (NEM) (among other things) was to introduce competition into the electricity market in those utility areas which were not natural monopolies. There is a range of material available evaluating the effectiveness of competition in the generation and retail sector, and largely it is positive. Transmission is nominally a transport monopoly however it does sit in a grey area in some respects, because it does play a large part in generator access to the NEM and consequently the competition between generators.

An issue which has been raised by the Federal Treasurer is the effectiveness of competition between the states in the energy sector. A large part of that problem is the limited capacity of

transmission interconnecting the states, and to some extent limited capacity of intra-regional transmission. Stanwell does not advocate uneconomic investment in transmission, but does question the comprehensiveness of methodologies in use in the NEM to evaluate transmission benefits. Despite the existence of the market benefits limb of the Transmission Regulatory Test, evidence of a lack of transmission in the NEM prevails, both numerical and anecdotal. Some points to consider in respect of that are:

- There is a perception of a lack of competition in the electricity sector between States (according to the Federal Treasury)

- The State based grids were developed with an emphasis on flow between generation source and load centre within the state, not on interconnection between states. There has been relatively limited development of interconnectors and associated supporting network at the boundaries between states (northern NSW and the boundary of SA and Victoria are good examples).

- There are frequently significant price differences between regions at times of only moderate stress on the NEM (high load and/or local shortage of supply) and there are significant differences in average spot price over longer timeframes. [2]

- The Background section Attachment A to the Rule change proposal discussed the history of the Regulatory Test, but did not point out that there had been no successful application of the Market Benefits Test to date. The only known *potentially* successful application of the competition benefits limb of the Regulatory Test is a low cost 200MW augmentation of the Queensland-New South Wales Interconnector (QNI) which cannot be justified until late this decade because of 'committed' generation between now and then.

- In Stanwell's view, generators who seek to limit the effectiveness of regulatory instruments that govern transmission development often have commercial interests in protecting their 'market' from access by other generators. Generators do not pay for transmission usage charges[3] and would naturally be neutral or supportive of transmission development because it improves network reliability and access to customers. The only logical reason a generator would object to transmission development (apart from a 'high ground' principle of limiting inefficient investment for general public good) is to prevent competition from other generators. Furthermore, a campaign which successfully restricts the effectiveness of the Regulatory Test[4] impacts

[1] Such as the N-1 approach used in Queensland

[2] Calendar year 2005 average spot price: Qld $25.06, NSW $35.52, Snowy $27.90, Vic $25.98, SA $33.24

[3] Appropriately so, because it is more efficient to recover transport costs as close as possible to end users.

[4] Ignoring customer benefits and wealth transfer in the Market Benefits limb has achieved this. The next step is to remove reliability criteria from the reliability limb and revert to a VoLL x Lost Energy approach.

the whole market, and will have a detrimental affect on competition throughout the NEM, not just in the area of the relevant generator. While Stanwell supports a generator's right to protect its commercial interest, regulators need to be conscious of how proposals submitted by generators in relation to transmission fit with the market objective of the 'long term interests of consumers'.[5]

- Conversely generators who support transmission development generally have low cost plant which has limited access to the whole NEM due to a lack of inter- and intra-regional transmission capacity.

Stanwell's argument is that the AEMC needs to consider whether additional transmission in the NEM would not in fact be economic on the basis of competition benefits, or whether the test for determining the competition benefits is inadequate. The evidence would indicate the current Market Benefits limb has failed, and needs to be reviewed.

THEREFORE, STANWELL RECOMMENDS THAT THE AEMC UNDERTAKE A FULL REVIEW OF THE MARKET BENEFITS LIMB OF THE REGULATORY TEST.

3. Issues for consideration in a review of the Market Benefits test

In undertaking that review Stanwell recommends the AEMC consider some of the following issues.

- Stanwell has previously stated that transmission in this stage of the development of the NEM is as much a matter of policy as it is economics. The policy direction seems clear at this point, namely increase the level of competition between states. Applying spartan economic principles which only account for the quantifiable benefits and ignore the unquantifiable benefits of transmission investment will not reach the goals set by Federal policy direction.

- For example, it is not clear how measurement of the "economic benefits to all those who produce, consume and transport electricity" properly captures the full benefits of network augmentation and satisfies the principle of "efficient removal of regional price differences". Furthermore, despite the claim in Attachment A of the Rule change proposal, it does not align with the market objective which is the "long term interests of *consumers* of electricity" (emphasis added).

[5] There is also the myth perpetuated that transmission 'competes' with generation which is an attempt to cloud the reality that it is generation at the other end of transmission that competes. Economic transmission development that provides for greater utilisation of existing generating plant provides both market and customer benefits.

- Treating the electricity market as an isolated system fails to take into account externalities. It is not sufficient to argue that if an externality cannot be measured that it should be excluded from the market benefits test. It appears that regulators have taken a 'once bitten, twice shy' approach to a full customer benefits test due to the SANI evaluation, rather than trying to make it work. While Stanwell is not necessarily advocating a full customer benefits test, some elements of customer benefits should be included in the test because of the role electricity plays in the economy and Australia's international competitiveness. This principle was surely in mind when the NEM Objective was developed.

- In addition there are taxonomy and public good benefits which are not taken into account in the test.[6]

- Incorporation of unquantifiable benefits in transmission investment decisions is a matter of policy. It has been widely acknowledged that micro-economic mechanisms which attempt to capture constraints costs, such as Firm Transmission Right payments or Congestion Support Payments are not sufficient to fund new transmission because they do not capture all the benefits. Electricity is complex and is not as conducive to reduction to a simplified form that can be modelled by classic micro-economics as other systems.[7]

- The decision about what unquantifiable benefits (and costs) to be included should not lie with the AER. Their primary role is regulator and should not be put in a position of making policy decisions about the role of transmission in the NEM.[8]

- Stanwell has made the point previously that the policy component of the revised market benefits test does not need to be in place forever. Once the 'state' based structure of the NEM has transmuted into the structure and form of a national market, augmentation from that point on can be readily assessed on the basis of less policy-oriented economic criteria if necessary.

4. Conclusion

In conclusion, Stanwell recommends that the AEMC undertake a comprehensive review of the role of transmission in competition and establish principles for the development or modification of the Market Benefits limb of the Regulatory Test which is consistent with Federal policy direction.

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[6] Frontier Economics Presentation to the NGF February 2004. Further information can be provided to the AEMC on request.

[7] Such as widget production into a market with elastic demand and limited transport costs.

[8] This is effectively what the Rule change proposes by requiring the AER to decide what cost and benefits are and are not to be included.