

GPO Box 520
Melbourne VIC 3001
Telephone: (03) 9290 1444
Facsimile: (03) 9290 1457
www.aer.gov.au

Our Ref: 41612
Your Ref: ERC0100
Contact Officer: Kate Murphy
Contact Phone: (02) 6243 1086

13 May 2010

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

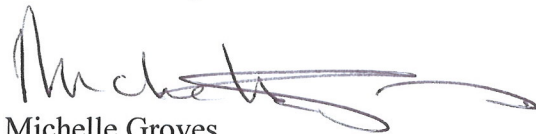
Dear Dr Tamblyn 

ERC0100—Scale efficient network extensions rule change proposal

Please find attached the AER's submission on the proposed National Electricity Amendment (Scale Efficient Network Extensions) Rule 2010.

Please contact me if you have any questions regarding the matters raised in our submission.

Yours sincerely



Michelle Groves
Chief Executive Officer



AER Submission

National Electricity Amendment (Scale Efficient Network Extensions) Rule 2010

Response to Ministerial Council on Energy rule change proposal and AEMC consultation paper

13 May 2010

1. Introduction

The Australian Energy Regulator (AER) welcomes the opportunity to respond to the proposed National Electricity Amendment (Scale Efficient Network Extensions) Rule 2010 ('SENE rules'). The AER has a particular interest in the SENE rules as the rules propose a number of new functions for the AER.

The AEMC's accompanying consultation paper addresses a wide variety of issues, ranging from questions about the efficiency benefits which underlie the proposed SENE rules to the ability of the proposed framework to deal with capacity and network issues which may arise in the medium to long-term operation of a SENE.

The AER has previously commented on the efficiency implications of the development of a new framework for connecting clusters of remote generation in its response to the AEMC's first interim report on the Review of Energy Markets in light of Climate Change policies ('climate change review'). In the submission, the AER commented that the proposed framework for connecting clusters of remote generation bypassed an efficiency assessment and had the potential to distort investment decisions by passing the risk of development onto consumers¹. The AER argued that market mechanisms may be best placed to ensure efficient investment outcomes and that regulatory intervention should be limited to removing impediments to market participants developing an efficient market response².

This submission now addresses the operation of the proposed SENE rules, with particular focus on the operation of the regulatory oversight provisions. However, as a more general observation, the AER notes that the proposed SENE rules are very long and complex, outlining prescriptive functions and processes for parties involved in or overseeing the development of a proposed SENE. This complexity and prescription may create significant upfront and ongoing costs for parties involved in the SENE process. The AER questions whether this is proportionate to the problems which the SENE rules seek to address.

2. Regulatory oversight functions

The proposed SENE rules provide for regulatory oversight of the application, design development and generator charges of a proposed SENE. The AER broadly supports such measures and reaffirms its view that regulatory oversight is needed to minimise the risks to customers of inefficient oversizing of SENE assets.³

2.1. Functions of AEMO

Under the proposed SENE rules, AEMO identifies in its annual NTNDP report SENE zones. Clause 5.6A.2(b)(2a) sets out a wide ranging and non-exclusive list of matters that AEMO must have regard to when identifying a SENE zone. As noted in previous submissions to the AEMC's climate change review, the AER supports the proposed

¹ AER, *Review of Energy Markets in light of Climate Change Policies Response to AEMC First Interim Report*, February 2009, p10-11.

² *Ibid*, 7.

³ AER, *Review of Energy Markets in light of Climate Change Policies Response to AEMC Second Interim Report*, August 2009, p3.

SENE rules giving AEMO wide discretion on the matters it can consider when identifying SENE zones.⁴

AEMO will also have a role in advising the AER on the reasonableness of a network service provider's (NSP) forecast generation profile when the AER is reviewing a NSP's SENE connection offer. Given AEMO's expertise in transmission issues, the AER considers that this role should be expanded to provide AEMO with the discretion to advise the AER on any aspects of the relevant SENE connection offer and SENE planning report. This is consistent with AEMO's role of providing advice on grid transmission development or projects which could affect the transmission grid under s49(2)(c) of the National Electricity Law.

2.2. Functions of the AER

SENE planning guidelines

Under the proposed framework the AER must prepare and publish SENE planning guidelines by 31 December 2010. The guidelines will outline methodologies and examples to determine the optimal line capacity, sizing, costs and revenue of a proposed SENE.

The AER considers that the date by which it must publish the SENE planning guidelines should be changed. Given the SENE rule is unlikely to be finalised for some months and the planning guidelines will provide guidance on complex economic and engineering issues, it will not be possible for the AER to follow the transmission consultation procedures outlined in the NER and prepare guidelines by 31 December 2010. Instead, the AER proposes that the rules require the AER to prepare these guidelines within twelve months of the proposed SENE rules commencing. This is consistent with the timeframe afforded to the AER to develop the regulatory investment test for transmission (RIT-T) and associated RIT-T application guidelines.

The AER also considers that an NSP should be required to comply with SENE planning guidelines when developing a SENE connection offer and planning report. The AER should also have the discretion to consider the extent to which a NSP's approach to developing a SENE connection offer is consistent with the methodologies set out in the AER's guidelines when making a determination on whether a NSP's connection offer is reasonable. This will ensure consistency in the SENE process and minimise risks to customers.

Efficiency considerations in the SENE planning guidelines

The SENE planning guidelines require the AER to set out methodologies to determine the forecast generation profile, optimal SENE hub location, the SENE costs and the revenue requirements of a proposed SENE. The AER proposes that the AEMC also consider the possibility of giving the AER the discretion to include an economic test in the SENE planning guidelines which can be used by NSPs to determine whether material scale efficiencies exist and the best options for capturing those benefits. The

⁴ Ibid, 4.

AER considers itself well-placed to develop this type of test given its role in developing the RIT-T.

Determination of reasonableness

Under the proposed rules, the AER can reject a SENE connection offer if it determines that the NSP assessment in its SENE planning report is unreasonable. As stated above, the AER considers that it should have the discretion to consider that an NSP's assessment is unreasonable where it is inconsistent with the methodology or approach outlined in the SENE planning guidelines.

Publishing marginal cost data

Under the proposed SENE rules, the AER will prepare and publish approximate and generic marginal cost figures for categories of generating facilities. These figures will be used to calculate payments under the proposed constraint compensation regime.

The AER notes that, in the past, AEMO has commissioned reports calculating the short and long run marginal costing of generation facilities for the purpose of conducting market simulation studies⁵ as part of its National Transmission Statement (NTS) consultation process. Given its experience in this area, the AER proposes that AEMO be given the role of preparing and publishing the marginal costing figures for the constraint compensation regime.

In addition, the provisions regarding the publication of marginal costs of generating facilities may require clarification. Clause 5.5A.14(c) requires the AER to calculate "approximate and generic" marginal cost data. However sub-clause (3) provides that the AER may consider the generation facility location. This indicates that the marginal cost data may become very specific, that is providing marginal cost data for specific fuel types in various locations.

3. Contracted power transfer capacity

In its consultation paper the AEMC asked questions regarding the efficient allocation of SENE capacity and noted the potential for a generator connecting to the SENE with an agreed power transfer capacity of zero.

The AER agrees with the AEMC that the connection of interruptible generation beyond the power transfer capability of the SENE is likely to utilise the SENE more efficiently, particularly where generators with intermittent fuel sources, such as wind, are expected to connect to a SENE.

However, the AER has concerns regarding any framework which would allow a generator to generate in excess of its contracted power transfer capability where the capacity on the SENE is not fully subscribed. In these circumstances customers will continue to fund any shortfall in SENE charges and bear an increased risk that the full cost of the SENE will never be recovered. Allowing generators to connect beyond

⁵ ACIL Tasman, *Fuel Resource, new entry and generation costs in the NEM*, April 2009.

their agreed power transfer capability or with an agreed power transfer capability of zero should only be permitted when the capacity on the SENE is fully subscribed.

4. SENE charges

Under the proposed SENE rules, annual SENE charges are calculated by reference to the regulated WACC. As noted in earlier submissions to the AEMC's climate change review,⁶ given the additional risk of building a SENE is passed onto customers, the AER supports the use of the regulated WACC and not a higher rate of return.

5. Constraint compensation regime

The proposed SENE rules provide for a constraint compensation regime to reimburse generators connected to the SENE whenever they are constrained off below their contracted power capacity by another generator. This constraint compensation regime is overseen and administered by the relevant NSP. The proposed rules require an NSP to determine constraint compensation payments based, in part, on 'the additional trading amount a generator would have received under chapter 3 had it not been constrained off'.

The AER is interested in gaining a better understanding of how it is envisaged that this arrangement would work and whether it is akin to AEMO's role in determining compensation payments to market participants who complied with a direction.⁷ The AER notes that calculating constraint payments may require complex calculations, access to AEMO's market data and be beyond a NSP's area of expertise.

⁶ AER, *Review of Energy Markets in light of Climate Change Policies Response to AEMC Second Interim Report*, August 2009, p6.

⁷ See for example Synergies Economic Consulting, *Independent Expert Report Directions in Queensland and Victoria* August 2009.