Ref.:

10 March 2006

Mr John Tamblyn
Chairman
Australian Energy Market Commission
P O Box H166
AUSTRALIA SQUARE NSW 1215

Email: submissions@aemc.gov.au

Dear Mr Tamblyn

Reform of Regional Boundaries

Ergon Energy Pty Ltd (Ergon Energy) appreciates the opportunity provided by the Australian Energy Market Commission (AEMC) to comment on the proposed Rule change *Region Boundaries.* This submission is made by Ergon Energy in its capacity as an electricity retailer in the National Electricity Market (NEM).

Ergon Energy supports the development of efficient criteria for assessing regional boundaries in the NEM. In particular a transparent framework which facilitates efficient investment and efficient operation of the NEM. Given the risks (and resultant costs) associated with trading across regions any change to regional boundaries should be accompanied by significant net economic efficiencies and enhanced market operations.

Frequency of Regional Boundary Reviews

The current process of annual boundary reviews creates uncertainty for market participants and has the potential to negatively impact investment in transmission. While Ergon Energy supports the concept of less frequent reviews, it is not clear how the proposed regime – boundary review by application – will reduce uncertainty or increase transparency without the following being addressed.

Further clarity should be provided on how the AMEC will ascertain the net economic benefits of the region change to all those who produce, consume and transport electricity. That is, will the assessment be the net aggregated benefit of all impacted parties (as listed above) or an assessment of the individual net economic benefits for the identified groups. To provide regulatory certainty and consistency, a set of guidelines should be developed by the AEMC, in consultation with industry, on how these costs and benefits will be treated.

The guideline should also address how the AEMC will identify and measure the costs and benefits of a region boundary change when it adjoins a region that will change in the next three years. That is, the adjoining region has been identified and approved for adjustment via the regional boundary change criteria.

For completeness the guidelines should identify minimum information requirements for a region boundary application.

Process for Regional Boundary Changes

Ergon Energy will address the procedural order of regional boundaries in its submission to the *Congestion Management Review: Issues Paper.*

Ergon Energy believes three years (after the final determination) is an appropriate lead time for market participants to address any commercial and economic considerations associated with a change to a regional boundary.

Change Criteria

According to the economic criteria and thresholds identified by CRA, a regional change would occur in the event of the following:

- an increase in economic efficiency of dispatch of at lease $1 million per annum; or
- a change in locational price indicators sustained over the review cycle in excess of levels to be published annually that would provide indicative investments in generation plant an increase in annual revenue of 25 per cent of reasonable new entrant cost for each;

provided that:

- no region shall have a maximum demand of less than 200MW; and
- a separate region shall not be created where in the reasonable opinion of the relevant authority there is little prospect of market based investment within the review period.

Ergon Energy does not support the economic criteria developed by CRA as it is quite arbitrary. For example:

- a $1 million threshold might result in efficiency being improved in a relatively minor way, for example some fuel savings, but could,
  - have a big impact on what consumers pay; and
  - will not necessarily produce any tangible change in investment;
- the $1 million figure is quite low, especially given it may be of a similar order of magnitude to the costs expended in determining the efficiency gains associated with creating a region; and
- the 25 per cent revenue criterion appears to favour generation investment over transmission investment and seems an entirely arbitrary number.

Ergon Energy believes further industry consultation should be conducted on the economic criteria and thresholds to be applied.

Customer Pricing

Ergon Energy welcomes the Ministerial Council on Energy's (MCE) conclusion that no material efficiency benefits would be gained from a nodal pricing approach. Whilst this is the overarching objective, the proposed Rule does not preclude a number of regions being established within a jurisdiction; representing an incremental step towards nodal pricing. However, it does state that all consumers in a jurisdiction should see the same price.

This arrangement is likely to result in significant costs for retailers. Even if locational prices are faced by generators alone, this will impact retailers as in the absence of firm and permanently grandfathered transmission hedges, retailers will have to buy energy contracts at different prices from different generators. Also, even with transmission hedges, their non-firm nature will increase the risk faced by retailers and as a result place upward pressure on wholesale prices.

If the situation arises where a boundary change would create multiple regions within a jurisdiction, the AEMC should develop, in consultation with industry and key stakeholders, a mechanism to manage pricing.

We would welcome the opportunity to discuss our comments with you at your convenience. Please feel free to contact me on (07) 3228 7536 should you wish to discuss any aspect of Ergon Energy's submission.

Yours sincerely

Angela Moody
Manager Regulation Policy

Telephone: 07 3228 7536
Facsimile: 07 3228 7766
Email: angela.moody@ergon.com.au