

12 December 2005

Dr John Tamblyn
Australian Energy Market Commission
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By email: submissions@aemc.gov.au

Dear Dr Tamblyn

**AUSTRALIAN ENERGY MARKET COMMISSION REVIEW OF THE ELECTRICITY TRANSMISSION
REVENUE AND PRICING RULES: TRANSMISSION PRICING ISSUES PAPER**

Stanwell welcomes the opportunity to respond to the transmission pricing issues paper, published as part of review by the Australian Energy Market Commission (**AEMC**) of the electricity transmission revenue and pricing rules (the **issues paper**).

The issues paper canvasses a wide range of significant issues, however, in this submission Stanwell wishes to deal with only one, but very important, issue – that is market signals for locational decisions by generators and the asymmetric risks that generators face as a result of decisions by transmission network service providers in reconfiguring their networks and how these risks should best be dealt with in the overall scheme in which the transmission system operates.

In examining existing price and other economic signals in the National Electricity Market that provide incentives to generators to behave efficiently, the issues paper seeks views on the extent to which existing signals from aspects of the National Electricity Market arrangements (or requirements from regulatory settings outside the National Electricity Market) are sufficient to promote efficient behaviour by producers of electricity in the short and long run.¹

¹ Australian Energy Market Commission, *Review of the Electricity Transmission Revenue and Pricing Rules: Consultation Program – Transmission Pricing Issues Paper*, November 2005, p 41.

In respect of non-firm grid access for generators, an existing National Electricity Market arrangement that provides incentives to generators, the AEMC notes in the issues paper:

Non-firm access means that generator proponents should only locate in an area that has sufficient current and expected future transmission capacity for them to evacuate enough power to be profitable. This could mean either that:

- there is plentiful transmission capacity both now and in the future, in which case, it is efficient for the new plant to utilise the spare capacity that is available;
- there is limited transmission capacity available but the proposed generator is sufficiently lower cost than incumbents to regularly displace incumbents in the dispatch process – this is consistent with efficient utilisation of the existing network; or
- there is limited transmission capacity available, but an augmentation is expected to meet the requirements of the Regulatory Test... – a generation investment made on this basis would be consistent with minimising the overall cost of electricity supply.²

In this submission, Stanwell proposes an explicit rule to achieve the correct long run signals in the respect sought by the issues paper in the following statement:

[I]f a generator proponent behaves in accordance with these long run signals, it is likely that its investment decision will be efficient from a locational point of view.³

That is, the rule that Stanwell proposes in this submission is directed at ensuring that generators are confidently able to rely on long run signals in making locational decisions and this should, in turn, assist efficient decision making by generators, and therefore, the overall efficiency of the electricity network to the ultimate benefit of consumers of electricity.

Identification of issue

In making an initial investment in a generating facility one of the most important decisions that a generator makes is a locational decision – where the generator chooses to locate its facilities. A number of factors will influence this decision, with one of the most critical factors being the

² Ibid, p 40.

³ Ibid, p 40.

capacity, reliability and effective cost of evacuating power through the transmission network from that location.

Getting this locational decision right is central to the profitability of any generation project. Building generation facilities represents a long run investment (up to a period of 50 years) involving very high sunk costs.

In considering the transmission capacity that is available in the area in which the generation asset is to be located, generators will not only have regard to whether they are able to place the desired quantities of energy on to the transmission network, but also whether the configuration of the network will permit the generator to offer particular services that may be required from time to time, such as network support or ‘black start’ services.

Where a generator locates where there is no current network service, it is appropriate that the generator bear the cost of any network extension for so long as it is the only user of the network. However, recognising the extension may create opportunities for other potential users who cannot independently fund an expansion of the network, it is appropriate that the initial generator is encouraged to fund the expansion by the extension assets being re-classified as common services once other users connect or once the assets become part of the broader transmission pathways. However, it is important to note that the considerations with respect to re-classification of transmission services between connections services and common services is asymmetrical.

The generator, once it has made its locational decision, constructed the generation facilities and made ongoing investments in either maintaining or expanding the generating capacity of the facility, faces a risk that it is unable to independently mitigate or manage in any way – that risk is that the transmission network service provider may decide to reconfigure the transmission network in a manner that is deleterious to the generator. This risk can only effectively and efficiently be managed through the National Electricity Rules governing network planning, connection and pricing. A decision by a transmission network service provider to reconfigure the transmission network in the area in which a generator is located may harm a generator in two ways:

- first, it may result in assets that were previously shared network assets being reclassified as connection assets, the costs of which may be sought to be recovered from an individual generator;
- second, where a generator may have had access to the transmission network at a number of points, it may result in a change to these lines such that while the generator is still connected to the transmission network, the generator is unable to offer particular services that it was previously able to offer.

Please refer to the attached diagram which sets out an example of such a situation.

The first matter is one which falls within the scope of review by the AEMC of the electricity transmission revenue and pricing rules, and the second is relevant to the up-coming consultation on the Regulatory Test rule change proposal lodged by the Ministerial Council on Energy.

The risk that the transmission network service provider may reconfigure the network such that the generator is faced with significantly higher costs as a result of the reclassification of assets operates as a disincentive to investment in generation capacity. This means that levels of investment in generation may be less than efficient, and this will harm the long term interests of consumers of electricity with respect to price, reliability, and security of supply of electricity.

There are at least two circumstances which could give rise to a reclassification of an assets from an asset providing common services and/or a transmission network asset, to an entry asset. The first is where the transmission system network operator reconfigures the network such that a shared connection becomes one that that benefits a fewer number of generators than previously. The second is where a connection that previously benefited several generators, benefits fewer generators because of a reduction in the number of generators or loads utilising that connection, but not as a result of network reconfiguration.

Given the inability of generators to predict, and therefore internalise, manage or mitigate future alterations to the transmission network in their region that harm the generator, the generator should not bear the risk of these events. Should generators be forced to bear these risks, this will act as a disincentive to efficient investment which may ultimately increase the cost of electricity to consumers as well as have implications for reliability and security of supply.

Proposed rule changes to address the issues identified

Reclassification of assets that were previously shared network assets as connection assets

A rule change is required to safeguard the basis on which generators make investment decisions insofar as concerns the transmission network as it was configured at the time of making both initial and ongoing investments. Where relevant assets in the area are classified as network assets which provide a common service or transmission network assets, such assets should not be capable of being reclassified as an entry asset where such reclassification has a negative impact upon a generator who has made an investment decision in circumstances where that asset was classified as providing a common service or as being a transmission network asset.

Proposed text for rule change

A new paragraph should be inserted in clause 2 of schedule 6.2 (Categories of Transmission System Cost) to the following effect:

An asset that has previously been categorised as an asset which provided a *common service* and/or as a *transmission network* asset must not be re-categorised as an *entry* asset.

At the expense of additional complexity, the AEMC may also wish to consider a more sophisticated approach by limiting the application of the rule to the expected life of the generator. The rule could do this by providing that where a transmission network service provider proposes to re-categorise an asset from an asset which provided a common service and/or a transmission network asset to an entry asset, the transmission network service provider must identify any generators who are negatively affected by this proposal and negotiate an arrangement that would in effect preserve the existing categorisation for the life of a relevant investment. A 'relevant investment' would be any investment made by the generator in reliance on the existing categorisation of assets in the area in which the generator is located. In the event that an agreement was unable to be reached between the generator and the transmission network operator, this matter could be made subject to dispute resolution procedures in clause 8.2 of chapter 8 (Administration Functions) of the National Electricity Rules.

How the proposed rule contributes to the achievement of the National Electricity Market Objective

The National Electricity Market Objective is set out in section 7 of the National Electricity Law, and is reproduced below.

The national electricity market objective is to promote efficient investment in, and efficient use of, electricity services for 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.

Under the National Electricity Law, the AEMC has rule making functions and powers in respect of the National Electricity Rules. In performing or exercising these functions and powers the AEMC must have regard to the National Electricity Market objective.⁴

⁴ Section 32 of the National Electricity Law.

The rule change proposed above will contribute to the National Electricity Market Objective as:

- (a) the proposed rule will operate in such a way as to decrease the riskiness of already risky investments by generators in establishing, maintaining and expanding generation facilities, ensuring that investment is not discouraged by exposure to a risk that generators are unable to influence or mitigate in any way;
- (b) in helping to ensure that efficient investment is not deterred, the proposed rule should encourage competition in the upstream generation market, with consequential benefits in terms of price and quality for consumers of electricity;
- (c) the proposed rule should also enhance reliability and security of supply as investment in generation capacity will not be deterred on the ground that generators are exposed to the risk that at some point in the life of the investment their costs could significantly increase as a result of the reclassification of transmission assets in the area in which their generation facilities are located;
- (d) the proposed rule would specifically facilitate diversity of generator locations, thus enhancing reliability through reducing the risk to the system as a whole of localised service interruptions;
- (e) the proposed rule will have no net effect on the ability of the transmission network service provider to recover its costs of operating the network, but will ensure that transmission prices are structured in a way that does not deter the utilisation of generation network assets that are already in existence and have no alternative use – ensuring that the long term interests of consumers are promoted;
- (f) the proposed rule will enhance the efficiency of market related decisions by investors in respect of generation as the basis upon which the investment decision is made will be safeguarded, therefore, one element of risk that may otherwise dissuade efficient investment is controlled for;
- (g) in controlling for this one area of risk, the rule change should increase the willingness of investors to commit capital to the National Electricity Market, reducing the long term cost of the National Electricity Market;
- (h) the role of transmission pricing outcomes in signalling investment opportunities to potential investors in generation will be enhanced by the proposed rule as an element of ‘noise’ or uncertainty in that signalling is removed, meaning that investors are provided with greater certainty that the basis upon which they make their investments will not shift in a manner that is detrimental to them for the life of that particular investment.

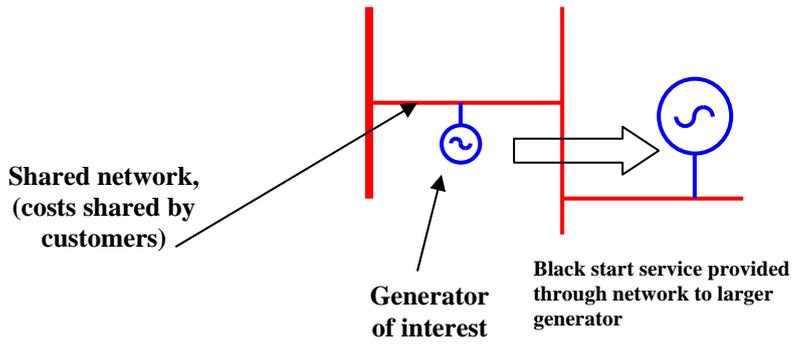
Should you have any questions in relation to this submission please contact Denis Warburton on (07) 3335 3846.

Yours sincerely

Gary Humphrys
A/Chief Executive Officer

Attachment

Example of the implications of removing existing network assets



Transmission line removed for reasons such as age, environment etc

