

## Appendix E Summary of related reforms

The Appendix presents the policy reforms, Rule changes, and Reviews that relate to the issues being considered in the Snowy Hydro proposal.

In its revised Congestion Management Program – Statement of Approach issued in December 2006, the Commission set out how it proposed to deal with these related Rule changes and Reviews in an integrated manner.<sup>248</sup> The Commission considers that all these elements under consideration contribute towards an effective congestion management regime and that the work should result in a regime that will be in place for the longer term and include mechanisms that address congestion in the short-to-medium term. In its Statement of Approach, the Commission also stated that it recognised there are issues of congestion management and boundary location in the Snowy region that are of more immediate significance and that the proposed Rule changes relating to these matters should be given priority.

The Commission plans to publish the Draft Report on Congestion Management Review and Draft Rule Determination on the MCE Rule change proposal on region boundaries together in June 2007.

### E.1 MCE's Rule Change proposal for the reform of region boundaries

The Commission received a Rule proposal on 5 October 2005 from the Ministerial Council for Energy (MCE) regarding region boundaries in the NEM. This was the result of a process of reviewing the region boundaries criteria following the initial determination on the region boundaries back in 1997.

Clause 3.5 of National Electricity Rules sets out criteria applying to the definition of a region, and the location of a regional reference node at where the regional price will be set. The original version of the National Electricity Code (NEC or the Code) envisaged that region boundaries would be reviewed annually, and changed as required to reflect and price new points of congestion. The Australian Competition and Consumer Commission (ACCC) required the National Electricity Code Administrator (NECA) to review the associated criteria within two years, as a condition of Code Authorisation under the Trade Practices Act<sup>249</sup>.

NECA undertook this task as part of its Review of the Integration of the Energy Market and Network Services (RIEMNS)<sup>250</sup>. NECA released the stage 1 final RIEMNS report in August 2001, and submitted the (as yet unpublished) stage 2 final report to the NEM Ministers Forum (NEMMF) in January 2002 to assist its review of transmission.

In early 2002 as required by the Code, NEMMCO commenced a consultation process on proposed region boundaries to apply from 1 July 2003. Subsequently, the NEMMF commenced a policy review of transmission. After consultation with

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<sup>248</sup> AEMC 2006, Congestion Management Program – Statement of Approach, 7 December 2006, Sydney.

<sup>249</sup> ACCC, *Applications for Authorisation, National Electricity Code, Final Determination*, 10 December 1997

<sup>250</sup> NECA, *The Scope for Integrating the Energy Market and Network Services*, Draft Report, October 2000.

NECA and the ACCC, NEMMCO suspended its review of region boundaries until the policy review was complete.

As an interim measure to provide market certainty, NEM Ministers place a moratorium on making boundary changes until a revised boundary process and criteria was developed. This moratorium has been in place since 2002, while the MCE has initiated broad ranging reviews of transmission regulation, pricing, and congestion management; and the criteria for changing regional boundaries.

In 2004 the MCE commissioned an independent economic study by Charles River Associates (CRA) to develop criteria and processes for boundary changes and initial boundary options. CRA recommended a move away from the original region boundary approach by reducing the frequency of region boundary change reviews and introducing a form of intra-regional congestion pricing and contracting to be implemented as an interim step<sup>251</sup>. The study recommended boundary change criteria based on improved economic efficiency of dispatch exceeding \$1 million, or the impact on annual revenues for indicative generation investments, subject to a minimum size for any new region. A five yearly cycle for the review of region boundaries was recommended. The CRA report recommended a staged approach to congestion management, moving from taking no action, to the introduction of CSPs/CSCs for constraints which are significant but not persistent, through to region boundary changes for material and enduring constraints.

The MCE subsequently consulted with participants on the recommendations included in the CRA draft report. On 20 May 2005, the MCE issued a statement on electricity transmission setting out its views on region boundaries, based on the findings of CRA, as follows:

- The MCE agreed that the regional structure for the wholesale market should be stable, based on current boundaries and with robust economic criteria to support incremental change as required.
- The MCE accepted CRA's advice that no material efficiency benefits would be gained from a nodal pricing approach at this stage of market development.
- The MCE supports giving advanced notice of a boundary change to allow participants the opportunity to adjust their contract trading positions and minimise commercial risk.
- The MCE notes the relationship between regional boundary review/change processes and the regulatory test, congestion management and the Last Resort Planning Power.

In its proposal, MCE state that the criteria in the existing Rules are technically based and backward looking. The MCE proposes to replace those criteria with forward looking and economically based boundary criteria. The Commission would assess

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<sup>251</sup> For the recommendations see: CRA, *Region Boundary Structure*, September 2004. For further detail see: CRA, *NEM Regional Boundary Issues: Theoretical Framework, Final Report*, submitted to the MCE, Melbourne, 14 September 2004; and CRA, *NEM Regional Boundary Issues: Modelling Report, Final Report*, submitted to the MCE, Melbourne, 16 September 2004

any application for a boundary change against these new criteria to determine whether the region change was likely to result in a material and enduring net economic benefit to the market.

The proposal suggests that Registered Market Participants or NEMMCO would put forth boundary change applications for consideration. The proposal also states that a region change application for a particular boundary could only be considered by the Commission every five years, unless market conditions around that boundary changed. This means that if the Commission considers an unsuccessful region boundary application, it would not consider any further applications to change a similar boundary within five years. If the Commission deemed a proposed change met the economic criteria, then the change would be implemented after at least three years' notice of the decision.

The MCE has also indicated that the Commission should have regard to a process that first applies a congestion management regime where material congestion emerges. The Commission is to only consider a boundary change where the network congestion is commercially material and enduring and there is no commitment to transmission investment to relieve the congestion problem.

On 14 December 2006, the Commission issued a notice in accordance with section 107 of the NEL, extending the period of time for it to publish a Draft Rule Determination in relation to this Rule proposal to 28 June 2006.

## **E.2 Congestion Management Review**

The MCE has also directed the Commission to review and recommend options for improved management of congestion in the transmission network (Congestion Management Review or CMR).

The CMR is expected to identify and develop improved arrangements for managing financial and physical trading risks associated with material network congestion. The CMR will also examine the feasibility of a constraint management regime as a mechanism for managing material congestion issues, until those issues can be addressed through investment or a region boundary change. In addition the Review will evaluate the relationships between a constraint management regime, constraint formulation, region boundary review criteria and review triggers, the Annual National Transmission Statement (ANTS) flow paths, the Last Resort Planning Power (LRPP), the Regulatory Test and transmission network service provider (TNSP) incentive arrangements in the manner they seek to manage and alleviate congestion.

The Commission published an Issues Paper on 3 March 2006 and intends to release a Directions Paper on the Review by February 2007.

### **E.3 Economic Regulation of electricity transmission revenue and pricing Rules (the Chapter 6 Rule proposal)**

The NEL requires the Commission to amend the Rules for electricity transmission revenue requirements and pricing matters. The Commission has undertaken this project in two phases: Pricing and Revenue.

On revenue, the Commission has clarified the revenue setting rules. The Commission considers this will provide TNSPs more certainty about recovery of costs for augmentation investments, including investment in alternatives such as network support contracts with generators or providers of demand side measures. The Commission published a Final Rule Determination and made the National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006 on 16 November 2006.<sup>252</sup>

On pricing, the Commission published a Final Rule Determination and Rule on 21 December 2006.<sup>253</sup> The Final Rule largely confirms the continued operation of current pricing methodologies while also providing scope for innovation into the future. This has been achieved by recasting the regulatory framework incorporating codification in the Rules of the key design features of the regime including:

- principles for prescribed transmission service pricing methodologies (arrangements for the pricing of negotiated services have been dealt with in the Draft Revenue Rule);
- the requirement for the Australian Energy Regulator (AER) to make guidelines in specific areas of pricing implementation and administration with a focus towards consistency across the NEM; and
- clear procedural requirements for the development, implementation and administration of pricing methodologies.

The Rule commences on 28 December 2006. The Commission considers that, in combination, the amended Rules will provide a balanced package of incentives on TNSPs to invest in and operate their networks efficiently while maintaining the quality and reliability of transmission services.

### **E.4 Last Resort Planning Power Rule change proposal (LRPP)**

On 12 October 2005, the Commission received a Rule change proposal from the MCE requesting the introduction of a Rule to provide for the Commission to have a Last Resort Planning Power (LRPP). Such a power would provide for the Commission to direct certain market participants to take the Regulatory Test in relation to potential inter-regional transmission investment projects across regions. Under MCE's

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<sup>252</sup> AEMC 2006, *National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006*, Rule Determination, 16 November 2006, Sydney.

<sup>253</sup> AEMC 2006, *National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006*, 21 December 2006, Sydney.

proposal, the Commission would be required to seek advice from the industry prior to exercising the power.

The proposed Rule seeks to ensure timely and efficient inter-regional transmission investment for the long term interests of consumers. The proposed Rule seeks to ensure that appropriate consideration is given to transmission investment in circumstances where existing incentives to undertake transmission investment may be lacking. These circumstances may arise where a potential transmission investment results in inter-regional benefits, which would result in positive net benefits to the market as a whole, but which is not economic for any one Network Service Provider operating in one region of the market.

On 23 November 2006<sup>254</sup>, the Commission issued a Draft Rule Determination on the LRPP Rule proposal, which largely accepts the MCE's proposed Rule. The Draft Rule provides an intervention mechanism for the Commission to ensure that appropriate inter-regional investments are examined. It does not give the Commission the power to direct market participants to make the investments. However, the Draft Rule would require the results of the Regulatory Test application to be published to inform potential investors of whether an economically viable project exists, thereby providing information for potential investors as to the viability of undertaking the investment.

## **E.5 Review of Regulatory Test principles**

Another Rule change proposal from the MCE sought to reform the principles of the existing Regulatory Test for assessing new transmission investment. The purpose of the Regulatory Test is to evaluate a proposed regulated transmission investment against all other reasonable network and non-network alternatives. The overarching objective of the Regulatory Test is to deliver economically efficient transmission investment within the NEM's network regulatory regime. The MCE's intention with this proposal was to provide greater clarity for the application of the Regulatory Test and reduce the scope for dispute, which has proved problematic in the past.

The Commission made a Final Rule Determination on the Rule change for the Reform of Regulatory Test Principles on 30 November 2006.<sup>255</sup> The Commission considers that the Rule change will allow the Regulatory Test to operate more effectively, providing greater policy guidance for the promulgation of the Test and increasing the certainty and transparency of the application of the Test. In its Determination, the Commission outlined a suite of principles that would provide minimum coverage guidelines for the AER to apply in promulgating the Regulatory Test. These principles include an economic and competition focus, which were underplayed in the original Regulatory Test. These principles are intended to establish a streamlined process that helps to maximise the net economic benefits to the market.

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<sup>254</sup> AEMC 2006, *Draft National Electricity Amendment (Transmission Last Resort Planning) Rule 2006*, Draft Rule Determination, 23 November 2006, Sydney.

<sup>255</sup> AEMC 2006, *Reform of Regulatory Test Principles*, Rule Determination, 30 November 2006, Sydney.

The Rule makes the market benefit limb of the Test simpler, through the provision of an information mechanism for alternative projects and requiring that the comparison of the proposed investment be made only against identified alternatives rather than all possible alternatives. The Commission considers that this will lead to greater incentives for TNSPs to utilise the market benefits limb of the Regulatory Test and this will facilitate investments to relieve congestion.

## **E.6 Comprehensive Reliability Review**

The Commission has requested the Reliability Panel<sup>256</sup> to undertake a comprehensive and integrated review of the effectiveness of NEM reliability settings, including whether there may be a need to improve or change them. The panel is focusing on whether an adequate level of generation and bulk transmission is made available.

The panel will release its draft decisions in February 2007, and intends to published its final decisions in June 2007.

## **E.7 Rule on the Recovery of Negative Inter-regional Settlements Residue<sup>257</sup>**

On 30 March 2006, the Commission made its Final Rule Determination and Rule on NEMMCO's proposal on the recovery of negative inter-regional settlements residue as part of the Settlement Residue Auction. Commenced on 1 July 2006, the Rule enables NEMMCO to recover outstanding negative inter-regional settlements residue (negative residues) from future auction proceeds rather than future auction fees. This reduces NEMMCO's recovery period from up to three years to a minimum of one month or a mean of two months, and therefore reduces the cost of cross-subsiding the debt over that period<sup>258</sup>.

In its Final Determination, the Commission stated that it did not consider the Rule on the recovery of negative residues was a long-term solution to the problems with the current Settlements Residue Auction and because it did not address the underlying causes of negative residues. Consequently, the Rule approved by the Commission by the Commission had a three year sunset and the Commission signalled that an alternative permanent means of managing negative residues need to be assessed as part of the CMR.

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<sup>256</sup> The NEL requires the AEMC to establish the Reliability Panel in accordance with the National Electricity Rules. The role of the Panel is: to monitor, review and report on, in accordance with the Rules, the safety, security and reliability of the national electricity system; at the request of the AEMC, to provide advice in relation to the safety, security and reliability of the national electricity system; and any other functions or powers conferred on it under the Law and the Rules. clause 8.8.1 of the Rules sets out the functions of the Panel in more detail.

<sup>257</sup> AEMC 2006, Recovery of Negative Inter-regional Settlements Residue, Final Rule Determination, 30 March 2006, Sydney.

<sup>258</sup> NEMMCO, Review of the Trigger Level for Management of Negative Settlement Residues, Final Determination Report, 27 October 2006, p.3.

## **E.8 Rule on the Management of negative residues in the Snowy region<sup>259</sup> and Determination on the Management of negative residues by re-orientation<sup>260</sup>**

On 14 September 2006, the Commission accepted the Southern Generators' and NEMMCO's Rule proposal (Southern Generators Rule) for an interim mechanism to manage negative residues in the Snowy region. The Rule commenced on 1 November 2006. The Commission concurrently rejected a proposed alternative to the same problem from Snowy Hydro and NEMMCO (Re-orientation proposal).

The Southern Generators Rule introduced a new process for managing negative settlement residues in the Snowy Region. It eliminated the risk of Victoria to Snowy inter-regional settlement residue (IRSR) units (in either direction) being in deficit, thereby eliminating the reason for NEMMCO to intervene in the operation of the market to impose, under the Part 8 derogation, an alternative constraint equation to restrict flow on the Victoria-to-Snowy interconnector (called clamping). Instead, the Rule enabled NEMMCO to offset negative settlement residues on the interconnector between the Victoria and Snowy regions using positive residues accumulated on the interconnector between the Snowy and NSW regions.

The Commission considers that implementing a short term congestion management pricing measure before adopting a regional boundary change is consistent with the approach proposed in the MCE's Congestion Management Review.

## **E.9 Extension of the expiry date for the Snowy CSP/CSC Trial and NEMMCO's power to manage negative residues**

On 14 December 2006, the Commission released a draft determination<sup>261</sup> to extend the expiry date for the Snowy CSP/CSC Trial and NEMMCO's power to manage negative residues from 31 July 2007 to the earlier of such time as there is a boundary change to the Snowy region or 30 June 2008.

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<sup>259</sup> Final Rule Determination, Southern Generators Rule, 14 September 2006.

<sup>260</sup> AEMC 2006, Management of negative residues by re-orientation, Final Rule Determination, 9 November 2006, Sydney.

<sup>261</sup> AEMC 2006, *Extension of the Participant Derogation in Part 8 of Chapter 8A of the National Electricity Rules*, (Draft) Determination, 14 December 2006, Sydney.

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