



20 December 2006

The Chairman
Australian Energy Market Commission
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Dear Dr Tamblyn

Draft Rule Change: Transmission Reconfiguration and Replacement

The National Generators' Forum (NGF) welcomes the opportunity to comment on the Draft Rule and Determination relating to Transmission Network Replacement and Reconfiguration released by the Australian Energy Market Commission (the Commission). The NGF note that the key elements of the proposal include:

- Acceptance that the Regulatory Test be applied to network reconfiguration and replacement investment;
- Not allowing for the payment of compensation to affected third parties arising from network reconfiguration or replacement investment; and
- The imposition of market information disclosure obligations on Transmission Network Service Providers (TNSPs).

Further to the initial submission provided by the NGF in relation to the Transmission Network Replacement and Reconfiguration Draft Rule Change, put forward by Stanwell Corporation Limited (Stanwell), the NGF provides the following comments in relation to the first two key elements of the Commission's Draft Determination.

1. Application of the Regulatory Test to proposed reconfiguration and replacement investments

"The Commission's draft decision is:

- *acceptance of the proposal to apply the Regulatory Test to reconfiguration investment;*
- *extension of the proposal by also requiring the Regulatory Test to be applied to replacement investment; and*

- *amending the threshold for the application of the Regulatory Test for reconfiguration and replacement investment to \$35 million.”¹*

The NGF supports the application of the regulatory test to network reconfiguration and replacement investment.

The NGF is concerned that the threshold proposed by the Commission will lead to inefficient outcomes and partially stranded assets for the following reasons:

1.1. Inappropriate criteria for establishing the value for the threshold

The Commission has determined the appropriateness of the value of the threshold in relation to the level of transmission investment, noting that transmission costs have increased since the establishment of the \$10M threshold (implemented in 1999), thereby arriving at a notional value of \$35M.

The NGF notes that the issue arises at the interface of the competitive and regulated sectors of the NEM and It possible that large supply investments could be impaired or stranded as a consequence of small investments in transmission.

The issue is not that a public consultation process and the application of the regulatory test would impose a significant regulatory burden on TNSP’s with no additional benefit to end users. This regulatory burden is potentially small when compared to the value of assets that could be stranded, the cost of which will also eventually flow through to consumers.

The Energy Reform Implementation Group (ERIG) review has identified that these interface issues between the competitive and regulated markets, are significant and that they need to be addressed to ensure long term economically efficient investment in the NEM.

For the above reasons the level of the threshold needs to be established on the basis of ensuring that generation assets are not impaired (or if the ability for generators to provide services is limited then compensation is required).

1.2. Lack of incentives to negotiate and lack of regard for non network alternatives

The Commission’s reasoning for accepting the application of the Regulatory test is that it is appropriate to consider some form of regulatory obligation on TNSPs to ensure efficient replacement and reconfiguration outcomes, because the alternative commercial negotiation and arbitration framework in the Rules might not be able to provide efficient outcomes because;

“First, there is no positive incentive in the Rules for a TNSP to negotiate with an affected third party user when a reconfiguration is proposed; and

Second, there are potentially insufficient incentives on TNSPs to ensure that a proposed reconfiguration is the most efficient approach to providing required network services, particular due to a lack of regard for non-network options”

¹ AEMC - Draft National electricity amendment (Transmission network replacement and reconfiguration) Rule 2006 -Page 19

The NGF is of the view that because generally generators do not have access rights written into their connection agreements with TNSPs and generators are unlikely to be able to negotiate any outcome with a TNSP let alone an efficient one, the regulatory test should be applied in lieu of a negotiated outcome. Further, to minimise the likelihood of inefficient outcomes the regulatory test should cover the bulk of the reconfigurations.

Commission's draft decision to apply a threshold between \$20 and \$50 million for projects that are subject to the Regulatory Test is likely to reduce the effectiveness of the draft Rule, as fewer projects will be subject to economic assessment and a negotiated outcome is unlikely for the remainder. In addition because this is an interface issue and because small transmission investments could have a large impact on generation assets the hurdle should be set in relation to the impact on generation not for reasons of uniformity in the regulated sector. In other words with a high threshold, potentially significant reconfigurations and replacements will be excluded. The NGF notes that this view is consistent with the original proposal put forward by Stanwell in its Rule Change Application earlier this year, which was designed to ensure that investments in network reconfigurations were linked to the economic impacts on market participants.²

For these reasons the NGF considers that the investment threshold should be set at a level of no more than \$10 million.

2. The payment of compensation to third parties impacted by a network reconfiguration investment

With regards to the second issue, the Commission did not accept the compensation regime proposed by Stanwell. The implications of this decision and suggested way forward are discussed below.

Implicit in the Commission's Draft rule to extend the Regulatory Test to replacements and reconfigurations is that there was a gap in the National Electricity Code as originally drafted. The reason for the gap is that the drafters of the Code clearly assumed, as was their experience up to that time that the network constantly expanded and elements were not removed or reconfigured. As a result, connection agreements were negotiated on this basis without specific regard to the general effects of reconfigurations and replacements.

On this basis, Stanwell as proponent of the Rule Change, has advised the NGF that following consideration of the Commission's views, it is proposing that a transitional mechanism should be provided for in the Rules that allows for the re-opening of connection agreements on the discrete issue of compensation in the event reconfigurations. Amendments should also be made to Rule 5.4A such that in respect of future connection agreements, TNSPs and Generators are required to negotiate in good faith in relation to the issue of compensation in the event of network a reconfiguration. The NGF is supportive of this approach.

² Stanwell proposed that Regulatory Test would apply in the event an TNSP estimates it will invest a total capitalised expenditure in excess of \$10 million or a TNSP has been advised by a market participant that it will incur a cost/forgo revenue in excess of \$1 million.

3. The imposition of market information disclosure obligations on TNSPs.

The NGF supports the Commission's draft decision.

If you wish to discuss any part of this submission, please feel free to contact the undersigned.

Yours faithfully

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Executive Director