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Dear Dr Tamblyn 

## National Electricity Rules - Rule Change Application Last Resort Planning Power

In accordance with s.91 of the *National Electricity Law* (NEL), the Ministerial Council on Energy (MCE) requests the Australian Energy Market Commission (AEMC) to make a Rule giving the AEMC a Last Resort Planning Power (LRPP) as set out in **Attachment B**.

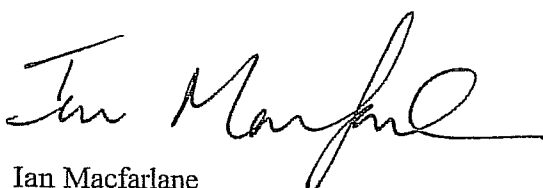
In the December 2003 MCE report to the Council of Australian Governments (CoAG), the MCE adopted four key principles to underpin transmission policy in the National Electricity Market (NEM). Within these principles the MCE agreed to a package of transmission reforms, including the development of the LRPP. The May 2005 MCE Statement on NEM Electricity Transmission draws together the various elements of the MCE Transmission Reform program including the LRPP.

It is the intention of the MCE that the failure to comply with a direction from the AEMC when exercising its last resort planning power will attract a civil penalty under the National Electricity Law. An appropriate Regulation prescribing the relevant provision as a civil penalty provision will be made in due course.

Further to the guidance provided in the above documents, a description of the proposed rule, statement of the issues concerning the existing rules, and how the proposed rule addresses those issues consistent with the NEM objective is at **Attachment A**. A draft of the proposed rule is at **Attachment B**.

The MCE would be pleased if you could have these matters considered by the AEMC. For further details, please do not hesitate to contact Loretta Boman on (07) 3225 8207.

Yours sincerely

  
Ian Macfarlane

## **Rule change request on Last Resort Planning Power**

### **Role of the Last Resort Planning Power in the Rules**

Under the proposed Rule change request for the LRPP, the AEMC will have a power to direct a relevant party to undertake the *Regulatory Test* for transmission investment. This will enable the AEMC to encourage preferred/needed transmission investment that has not been identified or proposed in the normal course of market development.

### **Background to Policy Position**

A robust and effective transmission planning process is integral to the realisation of a national grid as a platform for a competitive NEM.

The current market arrangements and regulatory processes for interconnector development may not deliver timely and adequate levels of transmission investment as there are no specific requirements that ensure an inter-regional network investment is committed. As an inter-regional asset will have a material inter-network impact, a potential investment is likely to require co-ordination between the effected jurisdictional networks which have caused delays to the application of the *Regulatory Test* for what are otherwise economic projects.

The MCE in its December 2003 report to CoAG endorsed a new NEM transmission planning process to improve consistency, transparency, and economic efficiency, particularly for inter-connector development.

In this regard, the MCE agreed to improved information provision through the Annual National Transmission Statement (ANTS), and a LRPP to be exercised by the AEMC, to direct that projects which affect *national transmission flow paths* (between regional reference nodes) be subjected to the *Regulatory Test* when normal market arrangements fail to promote efficient and timely investment to address material network congestion.

### **Statement of issues concerning the existing Rules and how the proposed Rule addresses the issue.**

Under the National Electricity Code (the Code), transmission network planning was state based and piecemeal in nature. The lack of nationally consistent planning arrangements was an impediment to efficient network investment. The Code also provided no obligations for network businesses to maintain efficient transfer capacity between regions. There has been no change to this under the transition to the Rules.

To address this issue, the MCE in its December 2003 report to COAG endorsed a new NEM transmission planning process to improve consistency, transparency, and economic efficiency, particularly for inter-connector development. This new planning process would provide industry with additional information to allow investment decisions to be more informed with regards to timing, location, and benefit to the market. This process would promote investment to take place when and where needed.

The MCE agreed transmission planning process is comprised by two parts.

Firstly, the ANTS, which details the major national transmission flow paths, forecasts inter-connector constraints, and identifies options to relieve constraints. The ANTS will be developed by the National Electricity Market Management Company (NEMMCO), in conjunction with market participants, and published annually in October in conjunction with the Statement of Opportunities. The first ANTS was published in 2004.

Despite these improved arrangements relating to information provision, the Rules do not specify particular requirements for inter-regional investments (unlike intra-regional investment which is mostly undertaken to comply with reliability standards). In addition, any inter-regional investment requires a proponent as the obligation for assessing whether a new inter-regional asset satisfies the *Regulatory Test* resides with the proponent (usually a jurisdictional planning body). As an inter-regional asset will have a material inter-network impact, a potential investment is likely to require the consent of both jurisdictions of the impacted networks. This need for co-ordination while necessary has prevented and delayed the *Regulatory Test* being applied to potentially economic inter-regional investment.

In this regard, the MCE agreed to a LRPP, to be exercised by the AEMC, to direct that options that address constraints affecting major national flow paths (between regional reference nodes) be subjected to the *Regulatory Test* when normal market arrangements fail to promote efficient and timely investment to address material network congestion. The results of the *Regulatory Test* application would be published to inform potential investors whether an economically viable project exists. While not actually directing investment to take place, the LRPP provides valuable information to potential investors.

These initiatives are important to provide a national focus for transmission planning and the information which underpins investment decisions in the market. A robust and effective transmission planning process is integral to the realisation of a national grid as a platform for a competitive NEM. This will come into effect through the disclosure of planning information for major national transmission flow paths identified in the ANTS, and facilitate timely and efficient augmentation of transmission networks through the *Regulatory Test* and the LRPP.

This request for a Rule change concerns the implementation of the LRPP.

### **Description of proposed Rule**

The proposed Rules will provide the AEMC with a LRPP to direct a party to undertake the *Regulatory Test* in relation to a *new transmission network investment*.

It is expected that the LRPP will be used to explicitly direct application of the *Regulatory Test* and that the power would not be used to bypass or override any criteria or processes specified in the *Regulatory Test*.

If the normal market arrangements have failed to provide efficient and timely incentives for the assessment of transmission investments which might be expected to satisfy the *Regulatory Test*, then the AEMC as the last resort planner may direct a party to undertake the *Regulatory Test*, and may elect to specify a particular option to be assessed.

It is important that any directed project is subject to the cost/benefits process (ie *Regulatory Test*), as the overarching objective is to deliver efficient transmission investment, not simply more transmission regardless of the economics. The *Regulatory Test* requires evaluation of non-network options as well, an important part of the economic efficiency discipline.

While there should be no Statutory requirement, regulatory best practice dictates that the AEMC as the last resort planner would, before directing a party to undertake the *Regulatory Test*, identify the failure of the standard process and the cause(s) of the failure. If the causes are, for example, due to poor policy settings, then the MCE should be advised in order that the MCE may seek to have that poor policy setting changed, rather than having the last resort planner direct a party to undertake the *Regulatory Test*. To do the latter would see the policy settings remain poorly set.

Factors relevant to implementation arrangements are:

- the LRPP is expected to be exercised rarely;
- the LRPP is to be exercised only where normal market arrangements have failed to provide efficient and timely incentives for the assessment of transmission projects which might be expected to satisfy the *Regulatory Test*;
- the LRPP does not extend to directing actual investment to occur; and
- the LRPP only applies to *national transmission flow paths* under the ANTS that lie between Regional Reference Nodes (i.e. transmission network that directly impact inter-regional transfers).

Applying the same rationale as that defined in ANTS, intra-regional transmission projects which significantly influence inter-regional transfers would also be subject to the LRPP. This would see an alignment between the application of the direction power by the AEMC and the concept of *national transmission flow paths* in ANTS. This broad definition is more capable of capturing the dynamic nature of the system associated with generation and load growth across the NEM.

In extending the power beyond a narrow interpretation of ‘inter-connector’, care will need to be taken by the AEMC as the last resort planner to ensure that the power does not inappropriately extend to projects which are substantially of an intra-regional or reliability nature.

For the purpose of clarification, it should be noted that the power is not intended to apply to non-transmission projects, i.e. generation or demand side. The ability to assess these projects as viable ‘alternatives’ to a transmission investment will however remain as part of the *Regulatory Test*.

In exercising the LRPP, the AEMC:

#### The Who – Who should the AEMC direct?

- is provided with reasonable discretion in determining who should be directed to undertake the *Regulatory Test*;

It is expected that the AEMC normally would direct the Transmission Network Service Providers (TNSPs) when exercising the last resort planning power, given that TNSPs will have ongoing responsibility for any inter-regional transmission investment undertaken as a result of a directed *Regulatory Test*. There may be circumstances (eg conflict of interest) where the AEMC may wish to direct other parties to undertake the *Regulatory Test*, and it is not proposed to restrict the AEMC to only directing TNSPs for the purpose of the LRPP.

#### The What – Application of the Power

- is provided with reasonable discretion in determining the circumstances in which the direction power may be exercised;

An explicit trigger for exercising the last resort planning power has not been specified under this Rule proposal. However, in exercising this power the AEMC must have regard to the [latest two] ANTS. From a procedural prospective, the AEMC must also have regard to the region boundary change process, the *Regulatory Test*, and any congestion management regime that may exist.

This allows the AEMC flexibility to respond to a policy direction from the MCE or autonomously on the basis of market information such as through ANTS or as otherwise obtained. Although it is intended that ANTS will be used to inform the AEMC of future market requirements, circumstances may arise which require the AEMC to look outside the scope of ANTS in determining whether a failure to deliver required investment has occurred.

Where network congestion is commercially material (ie priced by a congestion management regime) and enduring (eg has been flagged in the latest two ANTS publications), and has not been addressed by investment, it would be appropriate that the AEMC invoke its LRPP.

The AEMC should consider Rule changes that give effect to an explicit trigger for exercising the LRPP. As part of this Rule change proposal, the AEMC should be guided by the outcome of the consultation process when setting an explicit trigger for exercising the LRPP.

- should consider Rule changes that give effect to an explicit timeframe for the frequency with which the LRPP is exercised for the same or similar network investments.

The AEMC should have regard to whether the potential transmission project that is to be directed has previously been subjected to the *Regulatory Test*. The AEMC should be guided by the outcome of the consultation process when setting a definitive timeframe in regards to when the *Regulatory Test* was previously carried out and the results of the application.

### Defining the Project

- will be informed by a panel of industry representatives, established by the AEMC with technical support from NEMMCO when defining any project for which the direction power may be exercised. The AEMC should use its discretion in consultation with industry in defining the role of the panel and how the panel is constituted. Members of the panel must be *Registered Participants* and must include NEMMCO. Further advice or project specification could be provided by the relevant TNSP;
- will have the discretion to specify an alternative project for consideration;

In order to permit the AEMC to guard against the *Regulatory Test* carried out under its direction being one of process rather than substance, it is proposed that the AEMC have the discretion to specify an alternative project for consideration by the directed party in circumstances where it is satisfied that its concerns in issuing the direction would not be adequately captured in the course of the directed party carrying out the *Regulatory Test*.

This discretion only applies to those *Regulatory Tests* which are the subject of the AEMC's power of direction (ie not to each and every *Regulatory Test* undertaken by a party).

### Publication and Consultation

- is required to provide a statement of reasons for the information of the market when exercising the LRPP;

In recognition of the MCE's expectation that this power be used rarely and to ensure that the reasons for exercising the power are properly documented, it is proposed that the AEMC should provide a statement of reasons for the information of the market if the power is exercised.

A statement of reasons will assist the MCE and *Registered Participants* to assess whether the power has been exercised to correct inefficient market outcomes and to develop appropriate measures to redress any market failure.

While not issued as a consultation document, this process would assist in ensuring transparency and would mirror the existing practice by the TNSPs of flagging consideration of future investments. This would also assist in providing the market with adequate opportunity to consider alternative proposals to be raised for consideration in the course of the *Regulatory Test* consultation process.

### Timeframe and Conduct

- will have the discretion to impose a timeframe on commencement and conduct of the *Regulatory Test*, to be determined as appropriate in the context of the particular project under consideration;

The fact that a LRPP needs to be exercised may indicate that a party is not prepared to act as a proponent. Under these circumstances, there may be reluctance by the party to conduct the *Regulatory Test* in a timely manner.

Differences between projects and the number of alternatives to be examined complicate the identification of a 'one size fits all' timeframe.

It is recommended that the AEMC have the discretion to impose a timeframe on the commencement and conduct of the *Regulatory Test*, to be determined as appropriate in the context of the particular project under consideration.

However, it is the intention of the MCE that the failure to comply with a direction (under 5.6.5B (c)) from the AEMC when exercising its last resort planning power will attract a civil penalty under the NEL. An appropriate Regulation prescribing the relevant provision as a civil penalty provision will be made in due course.

To make this civil penalty provision effective requires the AEMC to exercise its discretion to impose a timeframe in each case.

### Cost Recovery

- will note that a directed party's costs incurred in undertaking the *Regulatory Test* are to be borne by the directed party.

The allocation of costs incurred in undertaking the *Regulatory Test* when directed by the AEMC is important for establishing the right incentives for institutions that are responsible for applying the *Regulatory Test* (eg transmission network service providers).

Permitting a directed party to recover its costs associated with a direction by the AEMC to undertake the *Regulatory Test* may remove the discipline on a party to initially apply the *Regulatory Test* in a rigorous and comprehensive manner, forcing the AEMC to exercise its directions power. The directed party thereby shifts costs that it would otherwise have incurred, to the AEMC.

It is therefore recommended that the costs associated with a directed party undertaking the *Regulatory Test* when directed by the AEMC are borne by the directed party. However, when issuing a direction, the AEMC should have regard to the directed party's costs in applying the *Regulatory Test*.

- may engage a party other than the directed party to undertake the *Regulatory Test* if the directed party fails to comply with the direction. The AEMC may wish to include a clause(s) similar to s.72 of the NEL to enable it to recover the costs associated from engaging another party if the directed party fails to comply with a direction.

It is noted that directing the *Regulatory Test* is not in itself a guarantee that the project will be undertaken – the AEMC’s power does not extend to directing investment.

However, the proposed Rules allow *Registered Participants* and *Intending Participants* to apply to the AER to determine whether a proposed network investment passes the *Regulatory Test* immediately following completion of the *Regulatory Test*. This is to provide certainty to a potential investor that the AER would permit the investment to be rolled into a business’s regulated asset base.

Where the AEMC has applied the LRPP and no investment proposal addressing the congestion has been committed for completion within a reasonable time period (to be determined by the AEMC), a regional boundary review may follow (this process is subject to a separate, but related MCE-initiated Rule Change Request).

The proposed Rule should contain such other necessary consequential changes that the AEMC deems necessary in order to achieve the proposed reforms.

A draft of the proposed Rules to be made is contained in **Attachment B**. These proposed Rules also contain a procedure for exercising the LRPP, which is not covered in this document, is in addition to core MCE policy, and is included as a basis for comment during consultation.

## **How the proposed Rule is likely to contribute to the achievement of the national electricity market objective**

### Promotion of efficient investment

The LRPP will compliment the ANTS, regional boundary arrangements, the *Regulatory Test*, and congestion management arrangements in encouraging efficient and timely investment in the NEM. When normal market arrangements fail to promote efficient and timely investment to address material network congestion, the LRPP will require the *Regulatory Test* to be undertaken.

The requirement that any direction is subject to the cost/benefits process (ie *Regulatory Test*), ensures the overarching objective of delivering efficient transmission investment, not simply more transmission regardless of the economics. The *Regulatory Test* requires evaluation of non-network options as well, an important part of the economic efficiency discipline.



### Promotion of efficient use of electricity services

The LRPP will ensure timely and adequate inter-regional transmission investment and send commercial incentives for generators and loads to make efficient decisions about the location of their production and investment activities. If these decisions are appropriately coordinated with decisions about regulated network investment the overall delivered cost of electricity will be more competitive.

### Long term interests of consumers

The long term interests of consumers will be enhanced through the promotion of efficient investment and operation of electricity infrastructure, not only in transmission services but also including generation and demand side response (as the directed party undertaking the *Regulatory Test* must consider network and non-network alternatives). This would ensure that the market had adequate opportunity to consider all proposals.

Efficient investment in transmission flows through to customers in the form of efficient prices, reliability and security of supply.

The LRPP will promote adequate and timely inter-regional transmission investment and will provide a safe, secure and reliable electricity supply to consumers that will minimise the possibility and impact of system security disturbances through the sharing of reserve capacity. The ability for power to flow freely between regions provides consumers with insurance in the unlikely event that multiple power stations fail.

### **Power to make the Rule**

The AEMC has the power to make the requested rule under s 34(1)(a) and (b) of the NEL. It also falls clearly within the head of power in clause 12 of Schedule 1 of the NEL relating to the augmentation or expansion in the capacity of transmission systems which is given effect by s. 34(2) of the NEL.

## Proposed insertion of a new clause 5.6.5B of the National Electricity Rules to provide the AEMC with a Last Resort Planning Power

### 5.6.5B Last resort planning power

- (a) The AEMC has a *last resort planning power* which it may use to direct a *Registered Participant* (the directed party) to apply the *Regulatory Test* to a *potential transmission project*.
- (b) When identifying a *potential transmission project* the AEMC must:
  - (i) establish and seek advice from a panel of industry representatives;
  - (ii) include NEMMCO on the panel for the purpose of providing technical support; and must have regard to:
  - (iii) the latest two *Annual National Transmission Statements*;
  - (iv) whether the *potential transmission project* has previously been subjected to the *Regulatory Test*, when the test was carried out and the results of the application of the test; and
  - (v) the likely costs of the directed party in applying the *Regulatory Test* to a *potential transmission project*.
- (c) The AEMC may exercise its *last resort planning power* by giving notice in writing, directing the directed party to apply the *Regulatory Test* to the *potential transmission project*.
- (d) The AEMC must *publish* a statement of its reasons for exercising the *last resort planning power* at the same time it issues a notice under clause 5.6.5B(c).
- (e) The AEMC may specify in a notice given under clause 5.6.5B(c) the following:
  - (i) one or more of the alternative projects which the directed party must consider when applying the *Regulatory Test* to the *potential transmission projects*; and/or
  - (ii) the time frame in which the *Regulatory Test* must be carried out by the directed party.
- (f) The directed party must comply with the notice issued under clause 5.6.5B(c) in all respects including any requirements in the *Regulatory Test* relating to consultation and the publication of the results of the *Regulatory Test* and any imposed time frame in which the *Regulatory Test* must be carried out.
- (g) If the directed party fails to comply with the terms of the notice issued under clause 5.6.5B(c), the AEMC may engage a party other than the directed party to apply the *Regulatory Test* to the *potential transmission project*.
- (h) The directed party or other party engaged under clause 5.6.5B(g) must *publish* a report setting out the results of the application of the *Regulatory Test* to the *potential transmission project*.

- (i) After *publication* of the report in clause 5.6.5B(h), any *Registered Participant* or *Intending Participant* may apply, in writing, to the *AER* for a determination whether the *potential transmission project* satisfies the *Regulatory Test*.
- (j) The *AER* must use the findings and recommendations in the report referred to in clause 5.6.5B(h), and may have regard to any other matter it considers relevant when determining whether or not the *potential transmission project* satisfies the *Regulatory Test*.

**New definitions –**

<b><i>last resort planning power</i></b>	The <i>AEMC</i> 's power of direction under clause 5.6.5B enabling it to direct a <i>Registered Participant</i> to apply the <i>Regulatory Test</i> to a <i>potential transmission project</i> .
<b><i>potential transmission project</i></b>	<i>New transmission network investment</i> identified by the <i>AEMC</i> which would, if constructed, relieve forecast <i>constraints</i> in respect of <i>national transmission flow paths</i> between <i>regional reference nodes</i> .