



14 March 2007

RECEIVED  
19 MAR 2007

Dr J Tamblyn  
Chairman  
Australian Energy Market Commission  
Level 16  
1 Margaret Street  
SYDNEY NSW 2000

Dear Dr Tamblyn,

### **ABOLITION OF SNOWY REGION, DRAFT RULE DETERMINATION**

Thank you for the opportunity to comment on the AEMC's draft rule change with respect to the abolition of the Snowy Region.

The transmission link through the Snowy region is critical to the efficient functioning of National Electricity Market, is vitally important in setting spot market prices across NEM and in the financial market. The Planning Council also recognises that there are serious concerns with the efficiency and competitiveness of the current Snowy Region arrangements and supports consideration of changes to congestion management through the Snowy Region. The Planning Council is concerned, however, about the context in which the draft decision has been taken and whether the immediate abolition of the Snowy region represents the most appropriate interim solution.

#### **1. Context for the decision**

As acknowledged by the AEMC, this decision is being made against a background of a number of reviews and Rule change proposals related to the reform of regional boundaries and congestion management within the NEM. Importantly the Commission's work program includes consideration of the:

- MCE's Rule change proposal on reform of region boundaries; and
- Congestion Management Review reference by the MCE

The Planning Council considers that these are the appropriate processes to assess long term solutions to the problems relating to the current configuration of the Snowy Region. The assessment of the proposed rule changes by Snowy Hydro and Macquarie Generation and the suggestion by Eraring Energy in this context should then be:

- whether the NEM objective is better met by making immediate changes to the current arrangements in the Snowy Region prior to making the longer term decisions on congestion management and regional boundaries; and
- if so, which of the options provide the best interim solution.

## **2. Is immediate action ahead of long term decisions warranted?**

The Snowy Region is critical to market outcomes and the regional definition is currently flawed. On the other hand, changes to the regional boundaries and the removal or addition of regions will introduce costs to NEMMCO and market participants and potentially impact on financial markets. The analysis undertaken for the Commission indicates that the immediate productive efficiency gains from a change to the regional structure are likely to be modest. The costs incurred in making an interim change need to be carefully considered in the context of the benefits that are likely to accrue over a relatively short period of time.

The greatest gains from improved definition of regional boundaries and constraint management are expected to be most significant over the longer term and relate to improved price discovery, and efficient pricing and investment drivers. The Planning Council is therefore concerned to see an effective regime emerge from the broader program of the AEMC. The Planning Council is concerned that without an effective regime in the future there is the potential not only for inefficiencies but even for perverse investment incentives. The risk of these costs appearing in the Snowy Region in the intervening period needs to be considered rather than the long term costs.

## **3. Does the abolition of the Snow region represent the best interim solution**

The Snowy region is complex but it is apparent that the most significant constraint is inside the region, between the Murray and Tumut, rather than at the boundaries of the region. A regional model cannot deliver a close approximation of efficiency, where pricing matches dispatch, if the regional boundaries do not pass through the most significant constraints. While this provides an argument for a regional boundary between Tumut and Murray we need to recognise that there are also important constraints between Tumut and Sydney and between Murray and Melbourne.

The option of the abolition of the Snowy Region therefore substitutes a better representation of one constraint with the removal of any mechanism to manage congestion on those other constraints. The extensive modelling undertaken by Frontier Economics on behalf of the Commission seeks to make a choice between these two flawed options. That modelling indicates that the case where the Snowy Region is abolished delivers a smaller reduction in efficiency than the current arrangements. The game theory modelling is, however, based on a model that includes a range of assumptions about the portfolios of different market participants and their costs, contract levels and commercial strategies. Each of these is likely to be change over time.

The option of splitting the region and creating two regions better reflects efficient pricing and dispatch through the region and this is also apparent in the modelling. As an interim option, however, this raises a number of concerns. While this better reflects congestion

through the Snowy Region, it is inconsistent with the management of other congestion in the NEM including, for example, congestion between the Latrobe valley and Melbourne. The equity and broader efficiency outcomes of this model would therefore be ideally treated within the broader review.

The other option to be considered in the intervening period, until a comprehensive congestion management regime is implemented, is to retain the current regional boundaries and the current CSP/CS trail and negative residue management arrangements. Whilst the Planning Council concurs with the Commission that this does not represent an optimal long term outcome, it should be seriously assessed as to whether it represents the best interim arrangement. The current arrangements are acknowledged by the AEMC as working and are an improvement over the 'business as usual case' used in the modelling.

### **Conclusions**

The AEMC is currently working on a major review and proposed Rule changes which will put in place the long term solution to Regional boundaries and congestion management in the NEM. The Planning Council considers that the decision on whether the Snowy region is abolished, split or otherwise changed in the intervening period should be considered and justified in that context. The Planning Council considers that the draft decision does not currently make the case that there an interim solution delivers benefits in excess of the costs and fails to consider maintaining the current arrangements as a possible interim solution.

Thank you again for the opportunity to comment, I would be happy to elaborate on any of the areas highlighted should you wish to discuss that matter.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'David Swift', with a stylized flourish extending from the end of the signature.

David Swift  
CHIEF EXECUTIVE