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Dear Sir/Madam

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Attention: Ms Alison Wiltshire

**TransGrid Submission to Ministerial Council on Energy (MCE) Standing Committee of Officials (SCO)
National Electricity Market (NEM): Regional Structure Review**

TransGrid would like to thank you for the opportunity to provide comments on this important consultation. This non-confidential submission¹ outlines TransGrid's views and concerns in relation to both the MCE SCO consultation paper (October 2004) and the Charles River Associates (CRA) "NEM – Transmission Region Boundary Structure" (Consultation Draft – September 2004) report.

Firstly, with respect to the **MCE SCO Consultation paper**, TransGrid at this stage of the development of the NEM, supports the SCO position on the following issues:

Region Boundary Change Process

- *"The SCO is broadly supportive of the recommendation for a stable regional structure. Compared to the dynamic approach envisaged in the current Code provisions, a stable regional structure would provide market participants with a higher level of certainty and would allow participants and intending participants to better manage commercial risk". (Page 3)*
- *"No material efficiency benefits would be gained from a nodal (more granulated) pricing approach at this stage of market development". (Page 3)*

Congestion Management

On the issue of CRA's proposed Constraint Support Pricing (CSP) and Constraint Support Contracts (CSC) TransGrid also agrees with the MCE SCO's that such a regime currently requires:

- *"further development following consultation on the merits of implementing such a mechanism". (Page 4)*

This opinion is based upon the current lack of robust details and analyses about the CSP/CSC regime, and on-going concerns about the potential commercial impacts of these type of proposals. TransGrid believes that without clear enunciation and explanations of the likely controversial processes in regard to:

¹ TransGrid is also an official signatory to another submission on this consultation that is being provided by the 'Newcastle' Group.

1. the likely allocation scenarios of such CSCs.
2. the management of potential “property rights” issues.
3. the likely governance frameworks to be implemented;
4. potential liability and accountability arrangements; and
5. commercial risk management issues

that the SCO view is the only realistic and practical position to currently adopt. As a result, the CRA CSP/CSC regime proposal does not seem to be sufficiently developed at this stage to be endorsed for full ‘in-principle’ support. Such a proposal involves a major alteration to the NEM, which could increase uncertainty and investor risks at a time when large amounts of new investment is required.

In commenting on the **CRA Consultation Draft paper**, TransGrid broadly endorses the following positions/recommendations.

1. That there is no need for a radical change to the current regional structure, without clear and unequivocal assessments for such change(s).

TransGrid notes that the CRA paper acknowledges that according to empirical analysis and subject to some exceptions:

“...pricing outcomes from a full nodal model are not significantly different to those resulting from the current regional concept. Accordingly, there is not a prima facie case to argue that greater variability in price differentials between nodes would result in substantially different and better pricing signals.”² and

“Modelling has indicated that for the overwhelming majority of the time and for the foreseeable future, nodal spot prices in the NEM are not expected to differ materially from likely regional spot prices... At least at this point in time, there would therefore be no benefit, in terms of materially improved pricing accuracy in moving to a nodal spot pricing regime on the basis of spot prices alone.”³

2. A form of 5-year cycle in reviews of region boundaries, rather than the current annual review process. (Recommendation 6)
3. The calculation and publication by NEMMCO of ‘shadow’ congestion prices. (Recommendation 7.3)

However, TransGrid would also suggest that there are some significant concerns with a number of the CRA recommendations and perspectives requiring further clarification and greater industry consultation, prior to any future implementation. These include:

- CRA’s proposed regional boundary criterion does not seem to be based on a robust analytical framework. With respect to the \$1 million dispatch efficiency benefit criterion (as proposed as one limb of recommendation #5) there is no clear justification provided for the adoption of this particular threshold.
- Further, any modifications to a regional boundary in the NEM would be associated with a number of costs. Some of these are readily quantifiable but many others are not, so thorough analyses will need to be undertaken to ‘fully consider’ such unquantifiable costs and benefits. A much better way to set criteria for regional boundaries would be to apply a form of cost-benefit framework similar to that of the ACCC’s ‘Regulatory Test’ evaluation framework.

² CRA Summary Report, page 23.

³ CRA Summary Report, page 34.

- Perhaps the most concerning aspect of all the CRA regional boundary criteria is the effective “veto” of the ‘relevant authority’ (presumably NEMMCO or the AEMC) currently contained as a part of recommendation # 5, where it (*the authority*) believes there is little prospect of market-based investment over the review period. This effectively puts the “authority” in a central planner position (with no clear-cut accountability or liability), which might be considered to be ‘beyond the bounds’ of this review.
- The proposal for broad indications of possible network augmentations that would pass the ‘Regulatory Test’ (Recommendation 7.2) seems of questionable relevance. There must be industry reservations over who could, and should, provide such broad indications. TransGrid as one of the NEM’s TNSPs already provide annual planning documents and input into the Annual National Transmission Statement process for NEM Participant consideration, which provides similar information. As a result this recommendation is superfluous, and should be deleted.

TransGrid is also aware that there is a possibility of a potential CSC trial (*at least in the form outlined by SnowyHydro at the most recent NEM Forum #63 on Thursday 28 October 2004*) with one likely consequence being that there will be a reduction in the monetary pool of inter-regional settlement residues. TransGrid would like the SCO to be very mindful that any resulting reduction in Settlement Residue Auction proceeds will:

1. Result in consumer rebate reductions, as the proceeds of these Settlement Residue Auctions are applied directly to reduce transmission charges to consumers. Such a move could see gains to one class of participant eg generators, at the expense of another participant class, in this case, consumers
2. Most likely lead to increases in effective transmission charges

that will necessitate a full examination of likely market behaviour and the potential impacts of such a move, by appropriate jurisdictions, NEM regulatory bodies, Market Participants, and consumers/customers.

I trust that these comments are of assistance and we would be happy to discuss any these matters further. Accordingly, please feel free to contact me on (02) 9284-3434 or via email: phil.gall@transgrid.com.au

Yours sincerely

[Original signed]

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