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# Ministerial Council on Energy

## Statement on NEM Electricity Transmission

May 2005

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### Introduction

In December 2003, the Ministerial Council on Energy (MCE) agreed transmission policy principles for the National Electricity Market (NEM) and announced a package of transmission reforms (see attached summary from the MCE Report on *Reform of Energy Markets – December 2003*).

This Statement summarises work that has occurred over 2004 in taking forward the reforms on transmission regulation, transmission planning and regional structure.

Drawing together the various elements of the MCE transmission work program is an important step towards achieving the COAG objective of a national transmission system. The MCE has confirmed that electricity transmission plays a vital role in influencing the nature and degree of market competition between individual market participants and within and across market regions.

Consistent with the work undertaken to date and the intent of MCE Ministers, the national character of the transmission system relies on three key elements – a secure and reliable transmission network, timely and efficient augmentation of major transmission flowpaths, and the use of a regulatory incentive scheme to more closely align transmission performance with their market impacts.

### Transmission Regulation

#### *Economic Regulation*

The National Electricity Law (NEL) has been amended to define the role of the Australian Energy Regulator (AER) with respect to its functions of economic regulation of transmission and oblige the Australian Energy Market Commission (AEMC) to develop Rules with respect to the process and methodology that the AER must follow in undertaking its economic regulatory functions.

The MCE will provide the AEMC with terms of reference to review the Rules for revenue and price setting for regulated transmission (currently chapter 6 of the National Electricity Code).

### *Regulatory Test*

The December 2003 MCE reforms included the development of a new Regulatory Test to recognise the full economic benefits of transmission, including where transmission is the most effective means of mitigating market power. The MCE also agreed to a level playing field between regulated and market transmission.

The Australian Competition and Consumer Commission (ACCC) has undertaken significant work in 2004 to amend the Regulatory Test, which now includes competition benefits as part of the Regulatory Test. The ACCC's work also delivers a reasonable framework for the removal of existing biases against the development of regulated transmission investment.

The MCE will develop Regulatory Test Principles that provide minimum coverage guidelines for the AER to apply in promulgating the Regulatory Test. The MCE will submit the Regulatory Test Principles to the AEMC for consideration as MCE-initiated Rule changes. The purpose is to provide a level of certainty in the AER's development of the Regulatory Test for transmission investments.

The AER will be responsible for promulgating the new Regulatory Test, noting the work done to date by the ACCC.

The AEMC will also be requested to investigate the merits for removing stranding risk for transmission investments that pass the revised Regulatory Test.

The MCE will continue to monitor the effectiveness of the revised Regulatory Test in delivering efficient transmission investment.

### *Dispute Resolution*

A streamlined dispute resolution process will be proposed for the Regulatory Test with clearly defined timeframes. Under the revised process, all matters relevant to the NEM that are currently heard by a multi-staged dispute resolution process will be heard directly by the AER.

The streamlined dispute resolution process will restrict those that can raise a dispute to:

1. *Rule Participants* – National Electricity Market Management Company (NEMMCO), any person registered with NEMMCO as a Market Participant, and for the purposes of the Dispute Resolution Process, this includes AEMC, Connection Applicants, and Intending Participants.
2. *Interested Parties* - a person including an end user or its representative who, in the AER's opinion, has or identifies itself to the AER as having the potential to suffer a material and adverse market impact from the recommended network development.

Disputes based on personal detriment or personal property rights, rather than on network issues and the operation of the NEM, will be heard through existing environmental and land planning appeal processes.

The streamlined dispute resolution process will be referred to the AEMC to translate into a series of MCE-initiated Rules changes, for consultation with the market through the AEMC's Rule change process in 2005. The AEMC will be requested also to examine extending the AER dispute resolution role to arbitrating transmission connection disputes.

### *Transmission Incentives*

Over the last 12 months, the ACCC has developed availability service standards and incentives for transmission service providers. This work has occurred in close consultation with industry and end-user representatives. The further development of an incentive regime will be a matter for the AEMC and AER.

The MCE will continue to monitor the effectiveness of the revised transmission incentive in mitigating the market impact of transmission system operation.

### **Transmission Planning**

The MCE has significantly enhanced the existing national transmission planning process through the development of two key initiatives - the Annual National Transmission Statement and the Last Resort Planning Power.

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, national electricity market. This will come into effect through the disclosure of planning information for major transmission flowpaths identified in the ANTS, timely and efficient augmentation of transmission networks using a revised Regulatory Test and the last resort planning power.

As agreed by MCE, the national planning process itself would be implemented by a panel of industry representatives, established and managed by the AEMC with technical support from NEMMCO, following a Rule change process initiated by the MCE.

### *Annual National Transmission Statement (ANTS)*

The inaugural ANTS was released to the market in conjunction with the Statement of Opportunities (SOO) in July 2004, providing the market with an integrated overview of the current state and possible required future development, of major national transmission flow paths in the NEM.

Additional work has been undertaken by NEMMCO, in consultation with SCO and industry, to progress development of the scope and content of the 2005 ANTS and supporting Rule changes.

To assist NEMMCO's work in this area, the MCE has agreed to the inclusion of minimal changes to the initial set of National Electricity Rules, including amending the publication date of the SOO/ANTS from 31 July to 31 October.

A comprehensive set of ANTS-related Rule changes are currently being developed by NEMMCO, and will be subject of a NEMMCO-initiated Rule change process through the AEMC in 2005.

Future development of the ANTS will be the responsibility of NEMMCO in consultation with industry representatives and the AEMC, consistent with the need to further develop the national transmission planning process.

#### *Last Resort Planning Power (LRPP)*

Under the proposed framework for the LRPP, the AEMC will have a power to direct a relevant party to undertake the Regulatory Test for transmission investment.

The policy framework for the LRPP will be:

- the power can be expected to be exercised only where normal market and regulatory 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 direction power will be a 'last' rather than 'first' resort and is expected to be exercised rarely; and
- the power of direction does not extend to directing that the investment occur.

The above framework will be referred to the AEMC to translate into MCE-initiated Rule changes, for consultation with the market through the AEMC's Rule change process in 2005.

#### **Regional Structure**

The MCE commissioned an independent economic study from Charles River Associates (CRA) to develop criteria for regional boundary changes.

The draft CRA study has been presented to the market together with a number of recommendations. In response to the draft report the MCE has formed the following views:

- **Regional Structure** - 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. MCE accepts CRA's advice that no material efficiency benefits would be gained from a nodal pricing approach at this stage of market development.
- **Frequency of Boundary Change** – The existing process of annual boundary reviews will cease. Two alternative options will be considered by the MCE: periodic reviews with a longer interval between reviews (eg. the 5-yearly cycle recommended by CRA); or boundary change assessment by application (eg. participants would apply to the AEMC for a review of regional boundaries under the formal regional boundary Rule change process). The MCE supports giving advanced notice of a boundary change to allow registered participants the opportunity to adjust their contract trading positions and minimise their commercial risk.

- **Change Criteria** – Criteria to amend boundaries should be forward looking and economically based. A net improvement to the efficiency of dispatch is considered a reasonable basis for the revised criteria. The MCE will undertake further work to refine the thresholds which will trigger a change. This will be reflected in the Rule change to be initiated by the MCE. There will be consistency in the economic criteria used for assessing regional boundary changes and for assessing transmission investment.
- **Constraint Equation Formulation** - All constraints should be developed in a consistent form. A form of constraint equation that allows NEMMCO to control all the variables (i.e. fully co-optimised direct physical representation) should be adopted by NEMMCO.
- **Dispatch Efficiency** - The MCE supports, as an interim measure, the current arrangements enabling NEMMCO to manage the occurrence of negative settlement residues, consistent with the current Code derogation (which has been extended to December 2005).
- **Inter-Regional Congestion Management** - The MCE, in its report to COAG of 11 December 2003 recognised the desirability of further developing inter-regional financial trading instruments. The MCE will direct the AEMC to consider the requirement for and scope of enhanced inter-regional trading arrangements following completion of the regional structures review, and taking into account the results of the Snowy trial, provided industry are consulted and broadly supportive.
- **Intra-Regional Congestion Management** – The MCE considers that there may also be merit in the introduction of financial instruments to manage intra-regional congestion including that which affects major national flowpaths. The MCE will direct the AEMC to further investigate efficient financial trading arrangements in the NEM, including proposals in the CRA study in relation to congestion management and pricing.

## **Implementation**

The key element of the MCE's transmission planning reforms, the Annual National Transmission Statement, has already been implemented with the launch of the inaugural ANTS in July 2004. The ANTS process will be incorporated into the National Electricity Rules following an industry consultation process.

Implementation of the additional MCE transmission reforms will occur when the AEMC becomes operational in 2005 through MCE initiated Rules changes and MCE directed reviews.

MCE initiated Rule changes will occur in relation to the following issues as outlined in the above sections:

- Application of Regulatory Test Principles;
- Dispute Resolution Process;
- Last Resort Planner; and
- Regional Boundary Structure and Change Criteria.

MCE directed reviews will occur in relation to:

- Merits of removing stranding risk for transmission investments that pass the new regulatory test;
- Options for improved financial trading arrangements to manage congestion;
- Revision of Chapter 6 of the Rules pertaining to network pricing for transmission and distribution systems.

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## **Attachment**

### **Ministerial Council on Energy Report on *Reform of Energy Markets* - *December 2003***

#### **Summary of MCE Electricity Transmission Recommendations**

- A new NEM transmission planning function to be developed, including an Annual National Transmission Statement (commencing in 2004) and a last resort power to direct that a project be subjected to the regulatory test.
- A new regulatory test for transmission to include the full economic benefits of increased competition, to be implemented in July 2004.
- A new process to be developed for assessing wholesale market regional boundaries, while maintaining jurisdictional boundaries for retail customer pricing. Initial report in June 2004.
- Improvements to inter-regional financial trading arrangements, to be evaluated in conjunction with future arrangements for regional boundaries.
- Market-based incentives for transmission performance to be developed, by July 2004.
- Conclude the review of transmission pricing arrangements, for implementation in 2004.
- Removal of existing biases in favour of unregulated transmission investment, in mid 2004. The code changes to recognise and protect the rights of existing investors in market transmission services.