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RECEIVED

14 MAR 2008

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Dr Tamblyn

Thank you for your letter of 27 September 2007 concerning the Australian Energy Market Commission's (AEMC) Draft Report on the Congestion Management Review (CMR). I wish to thank you and your staff for making a presentation recently on the CMR to the Ministerial Council on Energy's Standing Committee of Officials.

I note the AEMC's preference for an evidence-based approach to the CMR. It appears the available data has limitations as it is based on current market conditions and design as well as levels of congestion across the network.

Under current arrangements where intra-regional congestion is not priced, generators facing network congestion often have no incentive to disclose their real costs in their bidding behaviour.

I am advised that the result of this is that the real short runs impact of congestion on market outcomes is very difficult to observe in the operating market. Participants' bidding behaviour deals with the market as it exists and bids they would have made had there been no congestion are not known.

The Draft Report appears to have focussed on static efficiencies at the expense of long-term dynamic efficiencies. The Government notes that in rejecting the conclusions from a report by consulting firm IES focussing on dynamic efficiency, the AEMC stated that:

The Commission recognises that the dynamic efficiency aspect of congestion could have the largest effect on economic efficiency. Furthermore, with significant investment planned in the energy sector over the next 5 to 15 years, there will be potentially considerable dynamic efficiency effects for the NEM.

The Energy Reform Implementation Group (ERIG) also identified the dynamic efficiency problem.

Your report highlights that the Heywood interconnector experiences more hours of congestion than other National Electricity Market (NEM) interconnectors. The reason

for this is the constraint at Tailem Bend, which has been present since the market started. The AEMC does not suggest a solution to the problem other than to rely on the future National Transmission Planner (NTP) to resolve it.

There remains a serious risk that without proper incentives on generators they could locate in places, which increase congestion inefficiently. The NTP could only resolve that congestion by recommending network investment.

The arrangements for planning and developing the network have a key impact on congestion in the longer term. To rely too heavily on either individual Transmission Network Service Providers or an NTP takes the decision making away from the competitive market participants and places it in these bodies. The Government considers that trying to manage congestion primarily in this way fails to appropriate the benefits of the market and thereby ignores the problem of dynamic efficiency.

I note that the approach the AEMC has taken in its analysis appears to pay little regard to losses. I am advised that fixed loss factors can significantly misrepresent the actual losses under certain dispatch conditions especially in cases where the generator is actually supplying electricity against the flow of prices to another State. The Government is concerned that this is likely to be a significant ongoing issue for dispatch in the NEM given the abolition of the Snowy region.

Finally, the State Government notes your conclusion to the effect that congestion is a relatively small problem for the NEM at this time and that there is no urgency to address it. By contrast this may be an opportunity to make appropriate changes to deal with congestion before it becomes a larger problem, as you foreshadow that it will. This approach may provide for an easier transition. Importantly, developing the robust framework to support a sustainable congestion management regime will require a commitment so that the development work can proceed.

Should you wish to discuss this matter further please don't hesitate to contact Mr Vince Duffy, from Energy Division, Department for Transport Energy and Infrastructure on 08 8204 1724.

Yours sincerely



**HON PATRICK CONLON MP
MINISTER FOR ENERGY**

March
11 February 2008