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30 August 2006

Dr John Tamblyn
Chairman
Australian Energy Market Commission
Level 16
1 Margaret Street
Sydney NSW 2000

Dear Dr Tamblyn

Transmission Network Replacement and Reconfiguration

Thank you for the opportunity to comment on the above Rule Change proposal submitted by Stanwell Corporation.

In the attached submission, we have raised a number of areas that require careful consideration by the Commission. In particular, we are concerned about fundamental changes to the regulatory test that are separate from a wider review of its operation. We are also concerned about wider market implications which stem from compensation to generators as a result of changes to the network.

EnergyAustralia looks forward to continued involvement in this review and hopes this submission will provide assistance to the AEMC. Any enquiries can be directed to Mr Brendon Crown, Manager Regulatory Strategy on 02 9269 4351 or bcrown@energy.com.au.

Yours sincerely

George Maltabarow

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Managing Director

EnergyAustralia's Submission to the

Australian Energy Market Commission

Rule Change Proposal: Transmission network replacement and reconfiguration

August 2006

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Introduction

EnergyAustralia welcomes the opportunity to provide comments on the Rule Proposal raised by Stanwell in relation to Network Replacement and Reconfiguration.

EnergyAustralia is pleased that the Rule change request has been changed to focus on reconfiguration of transmission investment, rather than capture distribution investments as well. Nevertheless, we have some broad concerns with the Rule Proposal.

Extending the regulatory test to include network reconfigurations has the potential to delay transmission investment. EnergyAustralia has a small number of transmission assets that would be captured by such a change. While not envisaged in the Rule change proposal, similar application of the test to distribution reconfiguration would have considerable impacts for EnergyAustralia. There may be more merit therefore in including network reconfiguration as part of a wider debate on the principles, application and operation of the regulatory test.

If the Australian Energy Market Commission believes there is merit in proceeding with this Rule change outside of a wider review of the regulatory test, it should carefully consider the drafting of the Rule change proposal, particularly relating to definitions, thresholds, processes and obligations. EnergyAustralia believes the current drafting of the Rule proposal would have unintended consequences.

Requiring Powerlink to include the network reconfiguration in the regulatory test will not address Stanwell's main problem – which is the fact it will lose revenue and face additional costs as a result of a network reconfiguration. This relates to a broader issue of how a generator who has benefited from its position in the shared network (particularly regarding a legacy connection arrangement and the absence of transmission charges for incumbent generators) is treated if there are changes to the shared network that are not in the generator's favour. Extreme caution should be exercised when conferring rights on generators with regard to the shared network.

If anything, the proposed flow of compensation is in the wrong direction. If a reconfiguration is justified under the regulatory test, the TNSP should be compensated to the extent that the TNSP undertakes an alternative option (a non-least cost option) at the request of a market participant.

Analysing the nature of the problem

Stanwell perceives it has revenue at risk and faces additional costs due to the reconfiguration of the transmission network and is therefore seeking a solution via the Rules to mitigate or eliminate this problem. This proposal should be considered carefully, as the potential for revenue at risk in such scenarios is not limited to Stanwell and these particular circumstances. NRG Flinders highlights a similar scenario in its submission to the Ch 6 Revenue Rule Proposal.

Stanwell states that it has no option to mitigate the risk associated with Powerlink's network configuration. In EnergyAustralia's view this risk could be mitigated by Stanwell entering into a connection agreement with Powerlink for its existing connections. Alternatively, Stanwell could seek to negotiate an arrangement whereby Powerlink maintains the existing connection currently enjoyed by Stanwell. This arrangement would ultimately be paid for by the generator, but would be consistent with the arrangement entered into by other large network customers.

It appears that the central issue that Stanwell seeks to clarify is "what is the obligation of the TNSP to the generator in respect of access to the shared network, particularly where there is no connection service or negotiated arrangement?". It should be noted that this question is not

peculiar to instances of network reconfiguration, but is a question that has been asked and debated since the establishment of the NEM.

Issues surrounding open access arrangements of the market are currently being debated as part of more broad-scale reviews of economic regulation and congestion management. As we discuss below, the Rule change establishes a right for a generator to seek compensation as a result of a network change that modifies its ability to evacuate power to the shared network. This would set a dangerous precedent for market impacts resulting from all network augmentations.

Evaluating the extent to which amendments to the regulatory test will resolve the problem

Stanwell believes that the decision making standard that applies to significant new investments in the market should also apply to significant investments to reconfigure the network. Stanwell's proposed Rule defines reconfiguration as:

"Works which are not augmentations to:

a) permanently re-route the path of the network; or

b) modify the technical capabilities or usability for network Users of all or parts of a network..".

This establishes a very broad interpretation of a reconfiguration. Rerouting the path of the network could literally be considered as the work necessary to divert mains due to road reconstruction. Whilst this is not the intent of the Rule proposal, the wording could be interpreted this way.

Similarly, the requirement regarding modification of technical capability could be applied to the replacement of a sub-transmission substation where the replacement infrastructure provides a change in the technical capabilities through changes such as increased fault duties, changes from outdoor switchyards to indoor switchyards, etc.

With regard to transmission lines a reconstruction of an existing line in a more compact arrangement which altered its impedance would also modify the technical capabilities of the line.

The proposed definition makes it likely that all significant replacement projects would be considered as reconfigurations as it is difficult to identify a $10 million project that would not "modify the technical capabilities" of the network.

The majority of reconfigurations will have minimal effect on the market, but may involve significant cost. Therefore the threshold for market impacts should be much larger and more defined (annual impact, what impact relates to). If thresholds are set too low, on-time investment is at risk. It would not take much for a market participant to claim a $1 million impact from a network reconfiguration (a claim which would be difficult to substantiate if it involved effects other than network charges).

Stanwell assumes that because it is no longer able to provide System Restart Ancillary Services that this is an obvious cost to be included in the identification of options. However, EnergyAustralia questions whether this loss of revenue should be included at all. Rules should not treat the interests of one market customer above other existing or potential market customers.

In its submission to the Australian Energy Market Commission regarding the reform of Regulatory Test principles, EnergyAustralia raised several important issues about the purpose, role and operation of the Regulatory Test. Further to this, we still have some concerns about how the test would actually be applied in terms of ranking options where the proposal is a network reconfiguration.

EnergyAustralia believes that expanding the application regulatory test to network reconfigurations does not address the specific problem Stanwell is attempting to resolve, and is therefore of the view that there analysing the issues surrounding the application of the regulatory test for reconfiguration should be considered as part of a wider debate on the regulatory test principles and its operation.

Evaluating the extent to which compensation will resolve the problem

Providing compensation to Stanwell for lost revenue from reconfiguration would obviously solve the problem from Stanwell's perspective. However, any answer to the issue of compensation raised by Stanwell should be treated with caution. At the nub of this problem is the current inefficient transmission pricing arrangements, whereby incumbent generators do not pay TUoS charges. EnergyAustralia has long advocated a more efficient pricing regime, such as now exists in the UK at both transmission and distribution levels.

If compensation should be paid to an incumbent generator who loses revenue due to a network reconfiguration that benefits the market, what prevents compensation being paid to an incumbent generator who loses revenue as a result of network augmentation that benefits the market as a whole? EnergyAustralia strongly believes that the opportunities for a TNSP to compensate disgruntled market participants is potentially endless and a precedent should not be established.

In EnergyAustralia's view, there is more merit in the argument that a generator should compensate a TNSP to provide an alternative service to the extent that the cost of the alternative service is greater than the option chosen under the regulatory test. The Case Study provides an example of how this would occur.

In this environment, Stanwell could compensate Powerlink to maintain the existing service by the difference in cost between it and the reconfiguration.

Case Study: Compensation under the regulatory test

Consider Generator A, who has enjoyed the benefit of being attached to the shared transmission service and has 2 access points to the shared network. The Generator also benefits from being situated directly on the shared network so pays no entry and exit fees. Unfortunately one part of the shared network that connects to Generator A is nearing the end of its asset life and requires replacement. The estimated cost to replace the asset is $100 million.

The TNSP has found an alternative route that will still meet all security and reliability requirements. The cost of this route is $50 million. Unfortunately the reconfiguration will mean that one point of connection will be lost for Generator A. As Generator A is a Hydro, it bids in at peak price periods and also has a contract for system restart ancillary services with NEMMCO. The TNSP places the cost to the market of removing the connection to Generator A at $15 million.

Obviously the cost to Generator A from losing the SRAS contract and reduced dispatch is much more than the cost to the market. Generator A therefore enters into a negotiated service agreement with the TNSP for $35 million which represents the difference between the benefit from relocation (identified by the cost saving of $50 million) and the cost of relocation (which is based on the cost to the market from the relocation - $15million).