MCE
Ministerial Council on Energy

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Dear Dr Tamblyn John

**AEMC REVIEW OF TRANSMISSION FRAMEWORKS**

I am writing to you in my role as Chair of the Ministerial Council on Energy (MCE) about a review of transmission network frameworks as proposed in your Final Report for the Review of Energy Market Frameworks in light of Climate Change Policies.

As you are aware, at our meeting on 4 December 2009, the MCE considered the findings of the Final Report for the Review of Energy Market Frameworks in light of Climate Change Policies, and released its policy response to your recommendations.

As part of this response, the MCE agreed to ask the AEMC to review electricity transmission network frameworks in consultation with the Australian Energy Market Operator (AEMO) and the Australian Energy Regulator (AER). The review focus is on transmission investment, network operation, network charging, access and connection, and management of network congestion.

Attached is a detailed Terms of Reference for this task.

The MCE looks forward to working closely with the AEMC on this important market development initiative.

Yours sincerely

Martin Ferguson

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## TERMS OF REFERENCE – AEMC TRANSMISSION FRAMEWORKS REVIEW

At its 4 December 2009 meeting, the Ministerial Council on Energy (MCE) considered the AEMC's Final Report on its Review of Energy Market Frameworks in light of Climate Change Polices.

At the meeting, the MCE agreed a response which supported the AEMC's key finding that energy markets will generally be resilient to the anticipated impacts of climate change policies. However, the MCE also agreed that further work should be undertaken on the arrangements underpinning the provision and utilisation of transmission networks to improve their integration with the competitive electricity market.

The MCE notes that significant reforms to the framework supporting network investment have been, and are continuing to be, implemented. These include the regulation of transmission revenues, a new Regulatory Investment Test for Transmission (RIT-T) and establishment of the Australian Energy Market Operator (AEMO) as the National Transmission Planner tasked with publishing the National Transmission Network Development Plan (NTNDP). The new transmission planning arrangements were implemented on the basis of the following principles agreed by the Council of Australian Governments (CoAG):

- accountability for jurisdictional transmission investment, operation and performance will remain with transmission network service providers;
- where possible, the new regime must at a minimum be no slower than the present time taken to gain regulatory approval for transmission investment; and
- the new regime must not reduce or adversely impact on the ability for urgent and unforeseen transmission investment to take place.

CoAG committed to a review of the effectiveness of these arrangements after five years of their operation.

The MCE notes that the introduction of climate change policies is likely to drive major changes in patterns of generation in the National Electricity Market (NEM), with significant new investment in renewable and low carbon generators. In this regard, the MCE has recently initiated Rule change proposals to provide for Scale Efficient Network Extensions (SENEs) and Inter-regional Transmission Charging to ensure the existing framework is responsive to the challenges the NEM faces in light of climate change policies. The MCE recognises that these proposals could have significant impacts on electricity markets and the provision of timely and efficient new investment in transmission services.

The adjustment and further development of the NEM to address these issues in a timely and efficient manner will represent a considerable challenge, particularly given that much of the new generating capacity is expected to be located in areas remote from load centres and existing networks. These changes come at a time when much of the established network infrastructure is undergoing asset renewal and replacement, and when extreme weather events can impact on the security and reliability of electricity supplies.

The MCE therefore considers that the role of the transmission sector in ensuring that the electricity market is best placed to meet these challenges should be reviewed, recognising recent reforms to the transmission investment framework, with a view to ensuring that the incentives for future investment and operating decisions by generators and regulated network businesses are effectively aligned to deliver an efficient outcome overall. Such incentives should promote the provision of transmission capacity and services where and when required to meet the changing needs of the competitive sectors of the market in a timely, efficient and reliable manner in the long term interests of consumers.

The MCE has therefore agreed to direct the AEMC to conduct a review of electricity transmission frameworks in line with the Terms of Reference detailed below.

**MCE direction to the AEMC**

Section 41 of the National Electricity Law (NEL) enables the MCE to direct the AEMC to review any matter relating to the NEM or any other market for electricity.

Pursuant to section 41 of the NEL, the MCE directs the AEMC to conduct a review of the arrangements for the provision and utilisation of electricity transmission services and the implications for the market frameworks governing transmission investment in the NEM, particularly in light of the anticipated impacts of climate change policies and the potential impact of extreme weather events.

The AEMC's review should focus on identifying any inefficiencies or weaknesses in the inter-relationship between transmission and generation investment and operational decisions under the current market frameworks and amendments recently approved, having due regard for the limited time some of them have been in place. Where appropriate, the AEMC should recommend changes which would better align incentives for efficient generation and network investment and operation with a view to promoting more efficient and reliable service delivery across the integrated electricity supply chain.

Where deficiencies are identified in the incentives provided by the market frameworks, the AEMC should consider whether they could be satisfactorily addressed by incremental changes to the transmission arrangements or whether more fundamental changes are required, noting recent and ongoing reforms to the transmission framework. If the AEMC concludes that fundamental changes are essential, it shall consider whether there are any implications for the existing arrangements in the NEM and, if required, identify relevant options for change for consideration by the MCE.

In reviewing the existing arrangements and identifying any options for reform, the AEMC shall have regard to the National Electricity Objective in the NEL and the CoAG agreed principles detailed above. When considering potential proposals to amend the market frameworks, the AEMC should also have regard to the implications for trading and contracting risks and for investment and regulatory uncertainty, as well as the need for transitional and other arrangements to mitigate or manage such impacts.

This work should also take into account potential impacts of the new transmission-related measures recommended in the Review of Energy Market Frameworks in Light of Climate Change Policies. The MCE notes in its response to that Review that any future work should take into account the interaction of initiatives, including SENEs and Inter-Regional Transmission Charging.

*Specific areas for consideration*

In conducting its review, the AEMC shall have regard to the key areas outlined below, as well as any other matters it considers relevant.

These key areas should be considered together in a holistic manner, including assessment of the appropriate future role for transmission in providing efficient services to the competitive sectors of the NEM. The AEMC shall examine the nature, incentive properties and effectiveness of the existing access arrangements and alternative approaches to transmission service provision to the extent necessary for the purpose of this review. This should include consideration of the appropriate allocation and management of costs and risks across the market.

**Transmission investment.** The AEMC shall consider the extent to which the regulatory framework provides appropriate financial incentives on transmission businesses to ensure efficient and timely service provision. The AEMC should also assess the extent to which the planning framework is effectively aligned with the regulatory process governing transmission investment, including whether sufficiently robust information is provided to inform regulatory decision making. In addressing these issues, the AEMC should consider the impacts of climate change policies and the introduction of the NTNDP and RIT-T.

**Network operation**. The AEMC shall consider the nature, transparency and effectiveness of the current incentive arrangements governing network operation, availability and efficient service delivery. In particular, the AEMC shall assess whether these arrangements provide network businesses with sufficient financial incentives to operate their networks in a manner that optimises overall network availability and market efficiency.

**Management of network congestion**. The AEMC shall consider and, as appropriate, develop mechanisms that promote more efficient bidding and pricing behaviour by generators in congested parts of the network. It is key that, in developing mechanisms that address network congestion, the AEMC should assess the extent to which congestion, and measures to manage congestion, may impact on generation investment and the liquidity of forward markets (including intra- and inter-regional contracting). In particular, the AEMC should consider how dispatch and price risks might be mitigated with the objective of providing an increased level of certainty to all market participants.

**Network charging, access and connection.** The AEMC shall consider the effectiveness of the existing transmission network charging and access arrangements. In particular, the AEMC shall consider the development of improved locational signals for generators, and, if necessary, any implications for transmission pricing more broadly, including transmission pricing for load. The AEMC shall also examine the impacts of the existing access regime on generator investment decisions, and should assess the effectiveness of the current arrangements for connection services for generators.

*Establishing a Consultative Committee*

In tasking the AEMC to undertake this review, the MCE notes the importance of engaging with the energy sector and drawing upon relevant technical expertise.

In this regard, the AEMC is to establish a Consultative Committee comprising representatives from:

- AEMO;
- the Australian Energy Regulator;
- industry groups and representatives from electricity networks, electricity generators (including renewable generation), and electricity retailers; and
- energy user representatives.

**Timing and process**

The MCE requires that the AEMC:

- undertake a formal stakeholder consultation process, including the release at least one interim report consulting on its interim conclusions and recommendations;
- if considered appropriate by the AEMC, hold a public forum; and
- provide a final report setting out its policy conclusions and recommendations to the MCE by 30 November 2011.

The AEMC must publish a copy of the final report on its website once MCE has had at least two weeks to consider its recommendations.