RESPONSE TO AEMC PROPOSED RULE CHANGES

Reform of the Regulatory Test Principles

Reform of the Dispute Resolution Process for the Regulatory Test

Last Resort Planning Power

24 February 2006

Introduction

TransGrid appreciates the opportunity provided by the Australian Energy Markets Commission (AEMC) to comment on the above mentioned proposals from the Ministerial Council on Energy (MCE).

TransGrid's comments on the proposed changes to the National Electricity Rules (the Rules) have been developed in close consultation with other TNSPs. Accordingly, in a number of instances, TransGrid's assessment may be similar to, or the same as, those adopted by some other TNSPs in their final submissions.

Of particular note is that, while TransGrid recognises the policy level intent of the last resort planning proposal, this proposal, as currently constructed, does not appear to satisfy the statutory requirement of enhancing the NEM Objective. As such, TransGrid questions whether the AEMC has the statutory power to implement this proposal without material amendment. Suggested Rule changes have been provided to assist the AEMC in addressing this issue.

For further enquiries on this submission please contact Mr Philip Gall, TransGrid's Manager/Regulatory Affairs, in the first instance on 02 9284 3434.

In this context TransGrid's comments are set out below on each matter in turn.

Reform of the Regulatory Test Principles

TransGrid agrees with the establishment of Regulatory Test Principles within the Rules in that this is consistent with the current Governance arrangements involving separation of Rule making (AEMC) from Rule enforcement (AER). Without this change the AER would remain, in effect, the Rule making body in relation to the form of the Regulatory Test.

In terms of the proposed Principles these appear to largely reflect the status quo, which, by and large, appears to be operating satisfactorily from an implementation perspective. However, it needs to be recognised that the form of the Regulatory Test can be the major determinant of whether or not regulated transmission investment proceeds. In this regard a number of stakeholders, including end user representatives and, more recently the Council of Australian Governments, have expressed concerns regarding the adequacy of interconnection investment. Continuation of the current Principles, as proposed by this Rule change does not appear to address these concerns.

Nevertheless, and to the extent that the proposed Principles accord with the NEM Objective, TransGrid supports the Principles described in this proposed Rule. In particular, TransGrid endorses the recognition of the need for Transmission Network Owners (TNOs) to meet mandated network performance standards at least cost, and that, where appropriate, assessment of options is based on a form of cost–benefit analysis.

It is also recognised that the proposed Rule, and current regulatory test promulgated by the Australian Energy Regulator (AER) and reflects the outcome of substantial consultation with industry and other interested parties.

Reform of the Dispute Resolution Process for the Regulatory Test

TransGrid strongly supports the proposals for clarifying the dispute resolution process of the regulatory test, including, in particular, the proposed streamlined single-stage process, and the ability for a proponent to seek confirmation from the AER that a proposed project satisfies the regulatory test.

TransGrid also supports the retention of some of the key elements of the existing Rules, such as:

- the application of strict timeframes, particularly the 30 business day timeframe for the resolution of disputes relating to reliability augmentations;
- the exclusion of disputes of a frivolous or vexatious manner; and
- the grounds for dispute not including whether a reliability augmentation satisfies the regulatory test.

It is important to recognise that these provisions were originally established, after considerable stakeholder consultation, with the intention of balancing the need for affected stakeholders to participate effectively in the assessment process while ensuring the timely delivery of efficient transmission investment associated with ensuring network reliability and meeting the electricity needs of consumers.

Nevertheless, TransGrid considers that the NEM Objective would be enhanced with the following suggested amendments.

Clause 5.6.6(qb)

This clause, as proposed undermines the intended balancing of stakeholder needs with timely delivery of efficient investment and, as such, fails to enhance the achievement of the NEM Objective. As written, this clause could result in material delays to the AER making its determination and consequent delays to the delivery of efficient transmission investment.

Inclusion of this clause in the Rules would allow a party to a regulatory test dispute to delay payment of any costs invoiced to them, where delays in the assessment process could benefit that party's position. If s.72 of the National Electricity Law is deemed relevant for the default payment period, then the determination on an essential reliability augmentation could be delayed for a month.

One way to address this would be for the Rules to require the AER to indicate at the commencement of the dispute process which parties will pay costs. The Rules should also impose a timeframe for the payment of such costs, which, in the case of reliability augmentations, should be as short as reasonably possible.

Clause 8.2.1 (h)

An additional sub-clause under 8.2.1(h) that specifically excludes a dispute between parties under clause 5.6.6 or a determination by the AER under clause 5.6.6 would more clearly reflect the stated intent of this Rule change package. Furthermore, given that clause 8.2 no longer applies to regulatory test disputes, we believe that it would be beneficial for the Rules to require the AER to publish guidelines for the process by which disputes made under clause 5.6.6 will be managed.

5.6.6 (h)

The drafting of the proposed Rule can lead to confusion as to intent and does not clarify the standing and grounds for dispute, as stated in the MCE *Statement on NEM Electricity Transmission*. Specifically, it is unclear whether this clause is limiting what can be disputed or who may dispute a final regulatory test report. Consequently, there is a need to clarify the standing of parties to raise a dispute and the grounds for such a dispute.

Sub-clause 5.6.6(h)(3) also appears to be misleading. It appears to have been included to provide the desired single-stage dispute process, and seems intended to only be relevant where AER finds that a proposed augmentation is not a reliability augmentation. That is a party may successfully challenge whether a proposed augmentation is indeed a reliability augmentation, but this does not then necessarily mean that the augmentation does not satisfy the regulatory test. Hence the need for a conditional dispute to challenge the basis by which the applicant has assessed that the proposed augmentation satisfies the regulatory test.

Sub-clause 5.6.6(h)(2) could be simplified by removing the reference to criteria specified by the Inter-regional Planning Committee. This could be included in Chapter 10 of the Rules in the definition of “material inter-network impact”.

Similarly, sub-clause 5.6.6(h)(4) could be simplified by removing the reference to criteria specified by the Inter-regional Planning Committee. In this case, sub-clause 5.6.3(l) be deleted and the definition of reliability augmentation be amended to remove the word “solely”.

The term “economic side-effects that are periphery to the regulatory test”, in the last paragraph of 5.6.6(h), which seeks to restrict the grounds for dispute is unclear and inconsistent with terminology elsewhere in the Rules and related guidelines. To address this it is proposed that these words be replaced with wording that refers back to the regulatory test.

Drafting changes to address these matters would be similar to those set out below, but would need to be subjected to legal due diligence by the AEMC before incorporation.

(h) Only *Registered Participants*, the *AEMC*, *Connection Applicants*, *Intending Participants*, *NEMMCO* and *interested parties* may raise a dispute following the publication of a final report prepared under clause 5.6.6(f) or clause 5.6.5B(h) where the *new large transmission network asset* is a *reliability augmentation*. The only grounds for a

dispute to be raised under this clause 5.6.6(h) relate to the contents, assumptions, findings or recommendations of the final report prepared under clause 5.6.6(f) or clause 5.6.5B(h) with respect to:

(1) possible alternatives considered and their ranking under clause 5.6.6(b)(3);

(2) whether the *new large transmission network asset* will have a *material inter-network impact*;

(3) whether the *new large transmission network asset* is a *reliability augmentation*; and

(4) subject to the AEMC determining that the *new large transmission network asset* is not a *reliability augmentation* under this clause 5.6.6(h), whether the *new large transmission network asset* satisfies the *regulatory test,*

in accordance with the dispute resolution process in this clause 5.6.6. For the avoidance of doubt, *Registered Participants*, the *AEMC*, *Connection Applicants*, *Intending Participants*, *NEMMCO* and *interested parties* may not dispute any matters set out in the final report prepared in accordance with clause 5.6.6(f) or clause 5.6.5B(h) which relate to any cost or benefit that is excluded from consideration by the terms of the *Regulatory Test* or are based on personal detriment or property rights.

5.6.6(l)

This clause should be redrafted to clarify the standing and grounds for dispute of a non-reliability augmentation, similar to 5.6.6(h) above. Drafting changes to address these matters would be similar to those set out below, but would need to be subjected to legal due diligence by the AEMC before incorporation.

(l) Only *Registered Participants*, the *AEMC*, *Connection Applicants*, *Intending Participants*, *NEMMCO* and *interested parties* may raise a dispute following the publication of a final report prepared under clause 5.6.6(f) or clause 5.6.5B(h) where the *new large transmission network asset* is not a *reliability augmentation*. In addition to the grounds for dispute specified in clause 5.6.6(h), a dispute may be raised in respect of a final report prepared in accordance with clause 5.6.6(f) or clause 5.6.5B(h) as to whether the *new large transmission network asset* satisfies the *regulatory test*.

5.6.6(ld)

There are typographical errors in sub-clause 5.6.6(ld), and the sub-clause should probably read "…any matter raised by a party in the dispute ~~that~~ resolution process…"

Last Resort Planning Power

It is recognised that this proposal is an initiative of the Ministerial Council of Energy and therefore reflects the consensus of the NEM Governments on the policy principles to apply to transmission planning in the NEM. However, the NEM Governments have also established a statutory test in the NEL that must be satisfied before the AEMC is empowered to institute a Rule change. This test, that the Rule change must enhance the achievement of the National Electricity Market (NEM) Objective, is no less a reflection of the consensus of the NEM Governments than the last resort planning proposal itself.

In TransGrid's view this creates a dilemma for the AEMC in that the Rule change proposal, in its current form does not appear to satisfy the statutory test. Indeed, TransGrid would contend that the proposal, as it stands, adds costs to consumers without any measurable benefit and therefore does not meet the statutory test of enhancing the NEM Objective. In addition, TransGrid is not convinced that the proposal is needed to meet the underlying outcomes sought by the MCE.

To illustrate this position the benefits and costs are considered in turn, and suggestions are then provided as to the minimum amendments required to assist the AEMC in overcoming this apparent dilemma.

Benefits

The MCE's position on regulated interconnection investment appears to be clear in that the MCE is seeking to ensure that efficient interconnection investment proceeds. Similarly, the long term interests of consumers need to be enhanced to satisfy the statutory test and this would seem to be the case if this proposal resulted in improvements in bringing forward efficient interconnection development.

However, provided other relevant regulatory settings are correct the proposal is not needed to promote efficient interconnection investment. If these other settings are not correct then the last resort planning powers have no effect in any case. Either way the proposal does not appear to deliver the intended benefits. This outcome is better understood by examining the relevant regulatory settings.

The key regulatory settings required to deliver efficient regulated transmission interconnection are those related to motivating investment (incentives) and those that enable or prevent investment from proceeding (hurdles).

Commercially motivated TNSPs (all NEM TNSPs except VENCorp) will seek out regulated interconnection investment where such investment delivers commercial returns on the capital invested. This outcome can be achieved via the design of the electricity transmission revenue setting Rules currently being developed by the AEMC. Among other matters these Rules address investment stranding risk and the allowed returns on investment that is recognised as efficient. It is these Rules that provide the commercial incentives and hurdles faced by TNSPs in the delivery of transmission investment. Provided there is confidence that these Rules will remain relatively stable over the life of the investments in question they determine the transmission investment outcomes regardless of the proposed Rule change.

By way of example if regulated returns are set too low then there is no commercial incentive for TNSPs to conduct regulatory test assessments or deliver interconnection investment even if such investment is efficient. Even if the AEMC exercises its proposed planner of last resort power investment would not proceed if regulated returns were set too low. Such settings would provide inadequate commercial incentive for TNSPs to deliver the required investment. Alternatively, if the regulated returns are set at commercial levels then commercially motivated TNSPs will actively subject promising interconnection proposals to the regulatory test and the proposed last resort planning power would not be required in any event.

Similarly, the regulatory test is one of the (legitimate) hurdles that must be negotiated before a regulated investment can qualify for a regulated return. The more difficult it is to demonstrate that an interconnection proposal passes this test the higher the hurdle faced by the prospective investor. The exercise of the last resort planning power by the AEMC would result in a regulatory test being conducted but would have no impact on whether a given proposal passes this test. That is, the ability for the AEMC to exercise the proposed last resort planning power has no impact on the prospect of the investment proceeding. On the other hand, changing the form of the regulatory test to make it easier to demonstrate investment efficiency would reduce this hurdle and enhance the prospects of desired investment proceeding.

Costs

The conducting of a regulatory test, including the preparation of the supporting detailed technical and economic assessments, and the implementation of the associated consultation processes, is a costly exercise involving a significant commitment of relatively scarce expert resources. Furthermore, the opportunity costs associated with these resources being directed to unnecessary and poorly prioritised regulatory test assessments can be large indeed. Work on the most efficient transmission investments, including investments required to ensure system security and network reliability could be seriously delayed as a result.

Benefits Do Not Exceed Costs

Given the absence of demonstrable benefits, and the presence of material additional costs from this proposal this Rule change proposal does not contribute to the NEM Objective. As such the AEMC does not appear to have the power to implement the MCE's proposal.

A Possible Approach

In the event that the AEMC does identify material benefits from the implementation of this Rule, the NEM Objective would be enhanced if the costs to electricity consumers could be reduced. This could be achieved by implementing measures to minimise the prospect of unnecessary and poorly prioritised regulatory test assessments being initiated by the exercise of the last resort planning power. That is, additional provisions are required to ensure that the power is truly exercised as a 'last resort'.

In this regard TransGrid supports amendments that address:

- the pre-requisites for exercising the last resort planning power;
- the scope of projects that this power potentially extends to;
- the composition of the panel of industry representatives; and
- the potential for unreasonable costs to be forced upon a TNO.

There are no safeguards in the proposed Rule to avoid more widespread use of the last resort planning power than intended by the MCE. It is stated several times in the preamble that this power is to be applied to inter-regional issues and is expected to be exercised "when normal market arrangements fail to promote efficient and timely investment to address material network congestion". There is no clause in the proposed Rule to this effect.

In addition, the use of a panel of industry representatives, to define the options to be considered as part of a regulatory test, runs counter to directing effort towards the most economically efficient developments. This process amounts to initiating and developing regulatory test appraisals based on a consensus of vested interests, including a possible desire to achieve improved wholesale market positioning, rather than on the basis of an objective assessment of net economic benefits. As a minimum the Rule should specifically exclude any parties with a material trading interest in a given proposal from panel deliberations.

Given that there is no mechanism to recover costs, no specified timeframes and limited safeguards to exercise the proposed power only as a last resort, it is essential that the Rules require the AEMC to act reasonably when exercising this power.

To address these issues, sub-clauses 5.6.5B(a) and (b) could be rewritten to better describe the purpose and pre-requisites for the exercise of the last resort planning power. For illustrative purposes, and subject to legal due diligence by the AEMC, the following amended sub-clauses would appear to address the issues raised.

(a) The *AEMC* has a *last resort planning power* which it may use to direct a *Registered Participant* (the directed party) to apply the *Regulatory Test* where it reasonably considers there to be potential options that would relieve forecast inter-regional *constraints*.

(b) Prior to exercising its *last resort planning power* the *AEMC* must:

(i) establish and seek advice from a panel of industry representatives who shall not be associated with[1] market trading participants with a direct commercial interest in the outcome of the *Regulatory Test*;

(ii) include *NEMMCO* on the panel for the purpose of providing technical support

and must have regard to:

[1] There may be limited scope for allowing collective representation of generators and retailers. However, even this needs to be given careful consideration before including Rules to this effect. It remains questionable whether even sectorial consensus would lead to prioritising regulatory test assessments on the basis of economic efficiency.

(iii) the latest two *Annual National Transmission Statements*;

(iv) whether a *Regulatory Test* has previously been conducted on options to relieve the forecast *constraint*, when the test was carried out and the results of the application of the test; and

(v) the likely costs of the directed party in applying the Regulatory Test.

In addition to the serious issues identified above, the use of the term "project" should be replaced, as it is misleading regarding the purpose of the regulatory test. The regulatory test is not applied to a primary project, but to a range of options with a recommended option or project being the outcome of the test. A single project is only arrived at after the regulatory test is completed, when an application to establish a new large network asset is made, i.e. the outcome of the regulatory test must not be pre-empted.

Finally, TransGrid is concerned that the proposed Rule suggests that if a directed party fails to comply with all aspects of a direction then they may be required to pay for a third party to carry out the regulatory test. This raises the concern that if a TNO cannot justify a project to alleviate a constraint then pressure from market participants could lead to the AEMC directing an additional regulatory test at the expense of the TNO. This is unreasonable, and should not be provided for in the Rules.

Overall, it needs to be made clear within the Rule that all reasonable costs imposed on TNSPs by this process are to be passed through as adjustments to regulated revenue caps. To do otherwise would be inconsistent with NEL provisions entitling TNSPs to a reasonable opportunity to recover costs associated with meeting a service obligation.