



18 July 2019

The Commissioners
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Sent to: AEMC by online lodgement

Dear Commissioners

**Transmission Loss Factors Rule change proposal
Consultation Paper
ERC 0251**

Major Energy Users Inc (MEU) is pleased to provide its thoughts on the issues raised in the Consultation Paper relating to transmission marginal loss factors (MLFs) proposed rule change.

The MEU was established by very large energy using firms to represent their interests in the energy markets. As most of the members are located regionally and are the largest employers in these regions, the MEU is required by its members to ensure that its views also accommodate the needs of their suppliers and employees in those regional areas. It is on this basis the MEU and its regional affiliates have been advocating in the interests of energy consumer for over 20 years and it has a high recognition as providing informed comment on energy issues from a consumer viewpoint with various regulators (ACCC, AEMO, AEMC, AER and regional regulators) and with governments.

The MEU stresses that the views expressed by the MEU in this response are based on looking at the issues from the perspective of consumers of electricity but it has not attempted to provide significant analysis on how the proposed changes might impact generators, TNSPs and other stakeholders.

The MEU makes some general observations about MLFs and their purpose

-) Transmission loss factors (LFs), as well as providing a mechanism for charging for the losses incurred in electricity transport, are intended to provide a locational signal for both load and supply. While end users of

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electricity have both MLFs and transmission charges to provide a signal to a prospective load about the impact a specific location will have on the end user for its electricity needs, the LF is the primary signal that a generator sees about its locational decision as generators do not incur any costs relating to its use of the shared transmission assets to get their product to market. This makes the LF a very important element of generator locational decision making.

-) Once locations for generation and load are fixed, it is the way generators bid into the market that drives variations in the LFs. This means that some extent, the variation of MLFs is caused by generators themselves. It seems rather self-serving that generators complain about the variation in the MLFs that they, as a group, have caused.
-) The MEU has been a consistent advocate for setting transmission line loss factors to reflect the actual losses rather than those measured at the margin as using the MLF tends to lead to over-recovery of the actual losses incurred. So, even though the excess recovery might be returned to consumers, the return is socialised, effectively exacerbating the impact of the LFs on those incurring the loss as they only receive back a portion of the over-payment they make.
-) Consumers are also concerned that the MLFs vary so significantly, especially those located near to interconnectors. Some MEU members have seen their MLFs range from mid 0.9s to over 1.10 over a very few years. Such a variation, especially for large users of electricity, can cause considerable harm as they impact the costs of the products made.
-) The MEU has, in the past, raised the issue of the calculation of the MLFs with AEMO and pointed out that the current approach where AEMO uses the most recent financial year outcomes as part of its process of calculating the MLFs uses data that is quite out of date by the time the MLFs are published. The MEU has recommended that AEMO use the most recent calendar year outcomes as the basis as this uses data which is more current by at least six months¹.

The tenor of the rule change proposal is that generators should be part beneficiaries in the intra-regional settlement residue – IRSR. Effectively the proposal is that generators should share in the over-recovery that results from the use of the MLF rather than the cost of the actual losses. The MEU finds this unacceptable. The only signal a generator gets from the market to locate itself in the place that delivers the best outcome for the market as a whole (ie in the long term interests of consumers) is the LF. To weaken this signal by giving them a share of the IRSR does not meet the NEO as it weakens the incentive to locate new generation at the optimum location for the market needs.

¹ For example, the MLFs published in May 2019 are based on data for 2017/18 financial year. There is no reason that data from calendar 2018 could not be used instead

In response to question 3, the MEU comments:

-) The current approach to assessing loss factors on a marginal basis over-recovers the cost of the actual losses, resulting in a need to distribute this over-recovery. As the cost of the losses is transferred by “market consumers” to actual end users, over-recovery imposes an unnecessary cost on end users. The MEU considers that average losses rather than losses calculated at the margin should be the basis on which losses are attributed to end users
-) Over-recovery results in the need to distribute the over-recovery and the current approach distributes the over-recovery on a socialised basis, rather than to those that have paid in excess of the actual cost of these losses. This means that the current approach results in some end users providing a transfer of wealth to other end users – this is inequitable. This transfer of wealth can be minimised quite readily by assessing losses on an average basis as an average is more likely to reflect the actual losses incurred and therefore minimise any distortions in who pays how much for the losses that are incurred in the operation of the transmission network.
-) The application of the LFs is a balance between complexity and accuracy (increasing the frequency) and stability (LFs fixed for a longer period of time). End users have experienced the vagaries of the annual variations and would prefer greater stability but also recognise that the potential for under-recovery if LFs are set for too long a period. On balance, end users consider that an annual adjustment allows for the annual budgeting processes that end users face but at a sufficient frequency to minimise the potential of under-recovery.
-) When the debate was held to discuss the merits and demerits of backward looking and forward looking assessments of the MLFs, it was determined that there was little doubt that the backward looking basis was certain to deliver inaccuracies and forward looking was more likely to reflect the reality of what the losses might be for the coming year. The MEU considers that a forward looking basis is more likely to be correct for setting LFs than using a backward looking basis and therefore less liable for adjustment using the IRSR process.
-) The MEU is concerned about an application of a collar and cap approach to setting LFs. Arbitrarily constraining the size or range of MLFs weakens the locational signal for generators and load, especially for those locational decisions that would have led to LFs outside the range of the collar/cap. It will also lead to distortions and transfers of wealth from those entities that have located to minimise the LF impacts to those that would otherwise be exposed to them. The MEU does not support the application of collar or cap.
-) For the same reasons for not supporting a collar and cap to LFs, the MEU does not support the “grandfathering” of LFs.

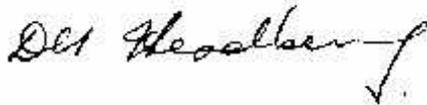
The MEU considers that the proposed rule change has arisen because of the influx of new generation locating at the periphery of the shared transmission network and incurring significant penalties as a result of the application of the MLFs. When the

MEU, on behalf of end users located at the periphery of the shared network sought to get relief from the imposition of very large MLFs, it was declared that the MLFs were needed so that other end users were not penalised by another end user deciding to locate where it did. At the time, it was accepted that the MLFs imposed an appropriate penalty on the end user's locational decisions. The MEU does not consider that this argument has changed as a result of it now being generators that are complaining.

The MEU considers that, other than moving to an average LF instead of a marginal LF, the current approach remains sound and that the AEMC should resist moderating the impact of locational decisions being made by new generation entering the market. The MEU considers that the current over-recovery of MLFs needs to be moderated to a level which, while still sending the correct locational decisions, could be based on an average LF which is less likely to over-recover the cost of line losses.

The MEU is happy to discuss the issues further with you if needed or if you feel that any expansion on the above comments is necessary. If so, please contact the undersigned at davidheadberry@bigpond.com or (03) 5962 3225

Yours faithfully

A handwritten signature in black ink, appearing to read 'David Headberry', with a checkmark at the end of the signature.

David Headberry
Public Officer