Grid access reform (COGATI) review – technical working group #10

24 July 2020

The tenth technical working group meeting was held by videoconference on 24 July 2020.

The technical working group was formed by the Australian Energy Market Commission (AEMC) to provide advice and input into the progression of the transmission access reform (COGATI) (EPR0073).

All enquiries on this project should be addressed to Russell Pendlebury on (02) 8296 0620 or Tom Walker on 0410 764 175.

The attendees of the meeting are listed below.

Member	Organisation
Aden Fanning	InterGen Australia
Andrew Kingsmill	TransGrid
Andrew Richards	The Energy Users Association of Australia
Anh Mai	AusNet Services
Arista Kontos	Australian Energy Regulator (AER)
Ben Skinner	Australian Energy Council
Bill Jackson	ElectraNet
Con Van Kemenade	Enel X
Dan Mascarenhas	AGL
Dr Darryl Biggar	Australian Energy Regulator (AER)
David Havyatt	Energy Consumers Australia
David Scott	Australian Energy Market Operator (AEMO)
Dean Gannaway	Aurizon
Gloria Chan	Clean Energy Finance Corporation (CEFC)
Greg Hesse	Powerlink
Henry Gorniak	CS Energy
Jack San	Ausnet Services
Jevon Carding	Lighthouse Infrastructure
Jill Cainey	Energy Networks Australia (ENA)
Joel Gilmore	Infigen
Killian Wentrup	UPC Renewables
Kirsten Hall	AEMO
Lawrence Irlam	Energy Australia
Lillian Patterson	Clean Energy Council (CEC)
Matt Dickie	Infigen
Mike Chadwick	The Australian Financial Markets Association
Miyuru Ediriweera	Public Interest Advocacy Centre
Nabil Chemali	Flow Power
Panos Priftakis	Snowy Hydro

Peter Nesbitt	Hydro Tasmania
Rimu Nelson	Cleanco
Robert Pane	Intergen
Ron Logan	ERM Power
Sam Ingram	Cleanco
Sarah-Jane Derby	Origin Energy
Stephanie Bashir	Representing Tilt Renewables
Tim Astley	TasNetworks
Verity Watson	Energy Networks Australia (ENA)
Wayne Gagel	Westpac

The AEMC's project team attended and is listed below.

Name	Position
Victoria Mollard	Acting Executive General Manager – Security & Reliability
Orrie Johan	Adviser – Transmission and Distribution Networks
James Tyrell	Senior Adviser – Transmission and Distribution Networks
Ella Pybus	Consultant – Cambridge Economic Policy Associates
Tom Walker	Senior Economist
Jessica Scranton	Lawyer
Tom Meares	Graduate Adviser
Peter Thomas	Digital Communications Manager
Declan Kelly	Senior Adviser – Security & Reliability
Ben Davis	Director – Retail and Wholesale Markets

At the start of the meeting, the 'competition health warning' was read out, and copies of the protocol (attached) were sent out to each member of the technical working group (TWG) in advance of the meeting.

Introduction

- The project team outlined that the purpose of this session is to discuss transitional arrangements, including the allocation of transitional financial transmission rights (FTRs) at the start of the regime, the shape of the allocation profile, who should receive them and other design questions.
- In addition to this, a potential measure to simplify the access reform model, involving setting up trading hubs, was discussed.

Objectives for Transitional Arrangements

- The project team suggested that there are clear benefits in making the transition to implement transmission access reform as smooth as possible
- The project team noted that a smooth and lengthy transition is provided in two ways:
    - a four-year implementation period i.e. a timeframe in the order of four years from when the rules are finalized to when the regime starts, with this taking into account consideration of other related reforms
    - a multi-year transitional allocation of FTRs to market participants, providing a 'soft start' to transmission access reform.
- The project team outlined the three objectives for the implementation timeline and transitional arrangements are to:
    - provide market participants and the Australian Energy Market Operator (AEMO) with a learning and adjustment period,
    - minimise sudden changes to operations, revenues and balance sheets, and,

    - balance the interests of incumbents with the interests of consumers and new entrants through the transitional period.
- The project team outlined that as was set out in the March technical specification paper, transitional FTRs would operate in the same way as FTRs purchased through the auction, but that they would be provided for free. The project team raised a number of questions relating to this decision:
    - What is the initial level of transitional FTRs that are to be granted?
    - Who should these transitional FTRs be allocated to?
    - How long should this initial allocation last for?
    - Over what period should the allocation be sculpted?

Key discussion points

- What is the initial level of transitional FTRs that can be granted?
    - It was suggested that any transitional FTRs allocated on day 1 of the reform should be reflective of as close to 100% of available network capacity as possible, which could be considered to approximate the implicit transmission access that generators currently obtain.
- It was noted that conservatism is likely required, as an overallocation of transitional FTRs may lead to issues around the firmness of these FTRs.Stakeholders generally agreed with this approach, but asked a number of clarifying questions: which included:
    - Participants sought clarity on the definition of an incumbent. The project team noted that this is still something that is being thought about, and we would be interested in stakeholder views. The project team's initial view is that existing participants at the time the rules are made would qualify for a transitional allocation of FTRs, which could potentially include any 'intending participants' classified as such under the NER.
    - Participants also asked what "100% of network capacity" means - the project team noted that this can effectively be thought about as the upper boundary of network capacity for the purposes of allocating transitional FTRs is the existing network capacity today.
- How are transitional FTR allocations adjusted over time?
    - The project team noted that there is a strong case for adjusting the allocation over time by sculpting i.e. reducing the quantity of transitional FTRs that are held by participants, because:
        - Existing market participants are provided with a learning period,
        - New entrants have the opportunity to adjust to the new framework, and
        - Consumers benefit from a period of stability.
- The project team noted that starting to sculpt transitional FTRs shortly after the implementation of the reform may achieve the transitional arrangement objectives.
- Stakeholder questions and comments on the adjustment of FTR allocations over time (and responses from the project team) included:
    - Some stakeholders expressed the desire for participants to be paying for FTRs as soon as possible. One suggestion was that more recent generators should receive less transitional FTRs.
    - Some participants queried whether an option was having no transition period or transitional FTRs may be an option.
    - Participants queried how de-rating of network capacity by network service providers would be accounted for when granting transitional FTRs.
    - Participants questioned how the capacity of the network is determined, whether it is current or a future projection. The project team clarified that we are seeking feedback on this point, and on how far into the future the projection should look, and what type of transmission infrastructure it should take into account (e.g. at a minimum committed projects under the ISP).
    - Some participants suggested that transitional FTRs should be allocated to parties that recently made investment decisions in good faith, and that older incumbents that have recovered the cost of capital may have no need for transitional FTRs.

    - Participants discussed the issue of whether sovereign risk is a factor in considering the need for transitional FTRs. Some stakeholders considered it was, others considered it was not.
    - Participants highlighted that it is important that a liquid secondary market exists to ensure trading to result in an efficient allocation of transitional FTRs following the initial granting.
- The project team discussed the question of who should qualify to receive transitional FTRs, including a number of issues, such as:
    - Should committed incoming market participants receive transitional FTRs? How should this be defined? Does the intending participant category fulfill that purpose?
    - Should new entrants during the four-year implementation period be eligible for transitional FTRs?
    - What should happen to transitional FTRs that are allocated to participants who then retire?
- Stakeholder questions and comments on who should qualify for transitional FTRs (and responses from the project team) included:
    - Some stakeholders suggested that if an investment is made after the rules are established and set in stone, then the investor should not qualify for transitional FTRs.
    - Others suggested that if we do not allocate 100% of transitional FTRs, then there should be room for new entrants to acquire FTRs.
- The project team also raised the question of whether market network service providers (the Basslink interconnector) should be eligible for FTRs.
    - Participants responded that market network service providers should not be treated differently to scheduled generators and so should be allocated transitional FTRs in accordance with the same approach.

Allocation methodology

- The project team explained that two potential approaches have been developed for allocating transitional FTRs between parties:
    - Method 1 uses actual historic data to determine a quantity of FTRs such that recipients would have been financially indifferent between the status quo and COGATI
    - Method 2 uses forecast estimates to determine a quantity so that recipients would be financially indifferent.
- The historic method uses historic locational marginal prices (LMPs), regional reference prices (RRPs) and dispatch quantities to determine the quantity of FTRs such that a participant's financial outcome would be unchanged. This means it would be based on historical, known information, but it would not necessarily guarantee that FTRs are simultaneously feasible (although this could be made possible through adjustments to the methodology).
- The forecast method uses forecast LMPs, RRPs and dispatch quantities derived from a forward-looking model. This would rely on forecasts of what may happen, but may also not guarantee that FTRs are simultaneously feasible (unless adjustments to the mechanism are made).
- The project team quickly outlined the pros and cons of each method, with those being:
    - The historic method is simple and uses actual data, however allocating based on the past may not mitigate against sudden changes or the broader changes occurring in the NEM.
    - The forecast method attempts to account for future changes but is more complicated and subject to varying views of the future NEM.
- Stakeholder questions and comments on the allocation methodology (and responses from the project team) included:
    - A participant offered a recap of one of the Optional Firm Access (OFA) allocation methods. The project team mentioned that this allocation method had been considered, but did not appear to achieve the transitional objectives as effectively as the other two methods. The project team agreed to review this method further.

- Stakeholders noted that each method could be tested from a quantitative sense fairly easily. The project team agreed to look into how this could occur.

Other design issues with the transitional allocation of FTRs

- The project team outlined other issues regarding transitional FTRs, including the firmness of transitional FTRs, and whether the products should be provided as options or obligations.
- The project team noted that the current design would result in transitional FTRs not being backed by FTR auction revenue.
- We asked stakeholder views on whether these FTRs should be options or obligations:
  - Option instruments would not make FTR holders subject to a liability when the price differences are negative (eg., when the RRP < the LMP).
  - In contrast, an obligation FTR would require its holder to make payments in circumstances where the price differences are negative.
- Stakeholder questions and comments on these design questions (and responses from the project team) included:
  - Participants suggested that the learning value of the transitional period would be maximised if the transitional period arrangements are as close to the enduring COGATI framework as possible, which would suggest that transitional FTRs should be options (the same as the enduring design).
  - Stakeholders expressed a preference for option instruments, with some stating concerns that obligations could create perverse market incentives and require a generator at a higher priced LMP to generate below their costs to avoid negative FTR payments.

- Participants asked to have a follow up open mike session in order to respond to some of the questions that were unanswered, and to have a more free flowing discussion. The project team agreed, and this was held on Tuesday 28 July.

Simplification

- The project team stated that there has been some feedback from stakeholders that the access reform model could be simplified, at least initially.
- This could potentially involve reducing the number of pre-selected transmission connection points, and creating FTR "hubs" – with FTRs only being sold at those hubs.
- The project team outlined that the benefits of this simplification are that:
  - the model is less complex,
  - there would be increased liquidity in each FTR,
  - that there would be reduced scope for the exercise of market power in the FTR market.
- The drawbacks of this form of simplification include:
  - not all basis risk will be covered by using the hubs. It leaves market participants with the risk of any remaining price difference between their connection point and the hub, and with limited means to manage this.
  - Deciding which nodes are included or not included may be difficult if congestion patterns are changing.
- Stakeholder questions and comments on simplification (and responses from the project team) included:
  - Some participants expressed enthusiasm for a simplified model, suggesting that a smaller range of products will not necessarily be detrimental to the market
  - Other participants suggested that hiding inherent complexity through simplified market design is bad practice, and that traders should be allowed instead to provide some form of simplification where they see the opportunity.
  - Stakeholders noted that the NERA modeling could provide insights in order to inform this decision.