

IRSR arrangements for transmission loops

We have published a directions paper to consult on a revised proposal

The Commission has published a directions paper to seek feedback on a revised policy direction for allocating inter-regional settlements residue (IRSR) in transmission loops. We have also published indicative rule drafting for feedback. The revised proposal takes into account the issues raised in the Australian Energy Market Operator's (AEMO) rule change request, our further analysis, and stakeholder feedback to our draft determination.

We are seeking stakeholder feedback by 10 July 2025.

The PEC transmission loop will lead to different IRSR outcomes

Project EnergyConnect Stage 2 (PEC) is a new interconnector linking South Australia and New South Wales which is expected to become operational from late 2026. Together with the existing interconnectors between New South Wales, Victoria and South Australia, PEC will create the first inter-regional transmission loop in the National Electricity Market (NEM).

IRSR is a surplus or deficit in NEM settlement outcomes that arises when electricity flows between regions with different prices. Currently, negative IRSR is allocated to the Coordinating Network Service Provider (CNSP) in the importing region, and the CNSP recovers it from consumers.¹ Positive IRSR is auctioned through the settlements residue auction (SRA) process, with auction proceeds allocated to the importing CNSP.

Due to the way that power flows in a transmission loop, negative IRSR arising on individual arms of the transmission loop is expected to be higher and more variable than it is in today's NEM. Currently, AEMO limits the magnitude of negative IRSR by 'clamping', which restricts the power flow over the relevant interconnector in dispatch. However, clamping all negative IRSR arising on the looped interconnectors could interfere with efficient dispatch – specifically, when the net loop IRSR is positive.

For this reason, AEMO will not clamp the looped interconnectors when the loop is net positive, and the resulting negative IRSR on the arms of the loop could pose a financial risk to consumers. This rule change considers how to allocate IRSR in a transmission loops in way that minimises the costs and risks to consumers.

The draft rule may not adequately address the risk of negative IRSR

Because of the potential for larger, unclamped negative IRSR, applying the existing arrangements to the looped interconnectors would result in:

- high risk for consumers themselves, who ultimately face the negative IRSR, and
- high cash flow risk to the relevant CNSPs, the cost of which is ultimately borne by consumers.

In the draft determination, we proposed to mitigate this risk by sharing negative IRSR for the looped interconnectors between the looped regions' CNSPs in proportion to regional demand. Based on stakeholder feedback and our further analysis, we now consider the draft determination is not the appropriate approach to manage the risk of negative IRSR arising on a loop.

¹ The CNSP is the transmission network service provider responsible for coordinating transmission pricing in a region. The CNSPs for New South Wales, Victoria and South Australia are Transgrid, AEMO and ElectraNet respectively.

We are proposing a 'netting off' approach for IRSR in transmission loops

The Commission considers that a 'netting off' approach for allocating positive and negative IRSR in transmission loops would best promote the long term interests of consumers. Under a netting off approach, negative IRSR is deducted from positive IRSR before positive IRSR is paid out to settlements residue distribution (SRD) unit holders. The Commission's further analysis, alongside stakeholder feedback, has informed our proposal. We also considered alternative options (discussed in our directions paper), including AEMO's proposal and keeping the existing arrangements. However, none of these options would adequately manage the risk for consumers without significant trade-offs.

The proposed netting off approach would prevent consumers from being exposed to an unhedged risk of negative IRSR, and would allow the interdependencies of IRSR on each arm of the loop to be managed by market participants who purchase SRD units. Market participants have appropriate expertise and tools at their disposal to manage inter-regional price risk, such as different types of contracts and hedging products. They could continue to use netted-off SRD units as part of inter-regional hedging strategies, because the proposed design would make all net positive IRSR in the transmission loop available to the market.

How our proposed approach would work

Our proposed netting off approach is as follows:

- When loop IRSR is net positive, negative IRSR in a dispatch interval would be deducted from the positive IRSR that arises on the other arms, in proportion to the size of the positive IRSR on each arm. This netted IRSR would then be allocated to SRD unit holders.
- When loop IRSR is net negative, any positive IRSR on any arm would be used to reduce negative IRSR in that dispatch interval.
- Any remaining net negative loop IRSR would be allocated to the CNSPs for the looped regions, in proportion to regional demand. CNSPs would in turn recover it from consumers.
- SRA proceeds (and any unsold SRD units) would continue to be allocated to the CNSP in the relevant importing region. CNSPs would then return this revenue to consumers.

AEMO intends to clamp the looped interconnectors in net negative cases, mitigating the risk of extreme net negatives being allocated to CNSPs and consumers. Furthermore, under our preferred approach, SRD unit payouts would never be negative. Rules for the loop would take effect when the loop begins operating, triggered by a transitional provision in the indicative rule drafting which defines a 'PEC operational date'.

A future review of IRSR arrangements may be needed

This rule change – and our proposed netting off policy – is focused specifically on the arrangements for allocating IRSR in transmission loops. However, we consider there may be a need to review IRSR arrangements more broadly to determine whether they best meet the needs of both the current and future NEM. A future review could examine additional issues not addressed in this rule change, such as:

- reviewing the allocation of all negative IRSR on all regulated interconnectors in the NEM
- re-examining the allocation method for SRA proceeds and unsold SRD units
- considering the role of SRD units in a future NEM.

We are interested in stakeholders' views on the need for, scope of, and timing of, a review.

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