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Dear Commissioners

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Inter-regional settlements residue arrangements for transmission loops — Directions Paper — 19 June 2025

EnergyAustralia is one of Australia's largest energy companies with around 2.4 million electricity and gas accounts across eastern Australia. We also own, operate and contract a diversified energy generation portfolio across Australia, including coal, gas, battery storage, demand response, wind and solar assets, with control of over 5,000MW of generation capacity.

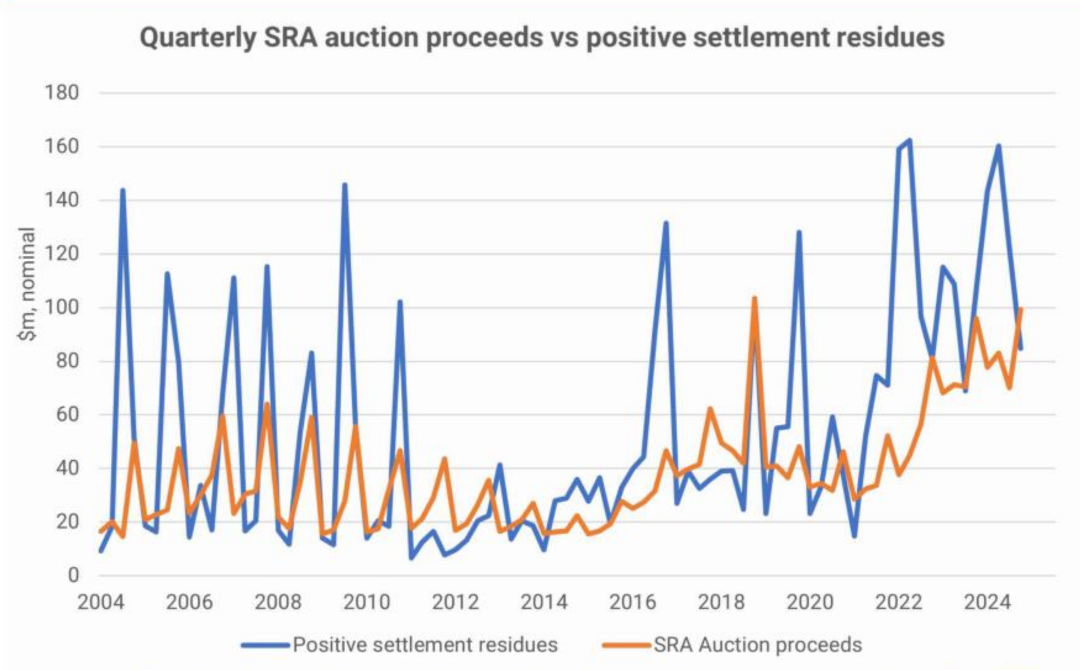
We appreciate the Commission undertaking further engagement regarding what is now a substantial change in approach from its December 2024 draft determination.

As we raised in our previous submission, the Commission is dealing with a complex topic. The Commission's view regarding the costs and benefits to customers of residue allocations and the role of settlement distribution (SRD) units needs to be tested with specialist traders. These transactions need to be considered from a market-wide perspective, including as part of participants' management of retail, contract and asset portfolios.

At a recent meeting with the Australian Energy Council (AEC), Commission staff indicated that they now intend to talk to trading experts, including on further issues arising in its directions paper. However the Commission expects to make a final determination in September. This leaves little time for it to form a fulsome understanding of how its proposed arrangements and alternatives would impact real life market outcomes, and ultimately consumers.

The AEC and other stakeholders already provided direct feedback on the Commission's suggestion that SRD payouts were anomalous and imposed a 'loss' to customers in aggregate over time. The Commission has not addressed this feedback, particularly the AEC's quantitative analysis. The directions paper repeats the Commission's earlier observation that settlement residue auction (SRA) proceeds are less than the amount paid out to SRD unit holders, with the same chart from its draft determination (as shown below). The Commission instead noted that there appeared to be limited benefit in further modelling or investigation ahead of Project EnergyConnect entering into operation, and this would potentially be the subject of a broader review of residue arrangements. That the Commission has still flagged a further review illustrates it does not yet appreciate the issues at hand. The Commission state that they "recognise there is a case to review the effects of a netting off approach on hedging and inter-regional trade at a later date."[1] This is central to the decision the Commission intends to make now regarding the allocation of risk and ultimate cost borne by consumers.

Figure 6.1: SRA proceeds are persistently lower than actual positive residues



Source: AER data, Quarterly settlement residues and settlement residue auction proceeds, December 2024; AEMO, Auction Report 2025, Quarter 1, April 2025, p.21.

We have some concerns that the Commission's misunderstanding of the pricing of SRAs i.e. as some sort of windfall gain to market participants, is infecting its view on how negative residues and risk should be dealt with. This is reinforced by instances in the Directions paper where the Commission gives assurances that "SRD units are guaranteed to pay out a positive amount, or at worst zero"[2], suggesting that market participants are concerned about losing payouts as if it were a stand-alone revenue stream.

Our understanding of the Commission's view, as expressed throughout in the Directions paper, is that:

- SRA arrangements generally, by only dealing with positive residues, inappropriately expose transmission network service providers (TNSPs) to downside risk, and this is a cost borne by consumers. That is, for SRD units to be

[1] AEMC, *Inter-regional settlements residue arrangements for transmission loops*, Directions Paper, 19 June 2025, p. 54.
[2] ibid., p. 19.

a proper hedge tool, they should symmetrically deal with negative and positive residues

- SRA auction proceeds reflect a surplus return for participants, and thus are a readily available pool of funding that can be used to absorb net negative residues

- while netting off negative residues from SRA proceeds will reduce their value as a hedging tool, participants will be able to value their risk exposure and eventually find ways to transact with willing counterparties to manage this

- market participants are the only party involved in these transactions that can deal with the risk of negative residues arising

- alternatives involving funding via TNSPs would be less efficient as they have no means of influencing interregional price differences and residue accrual, and cannot manage cashflow impacts from residue allocations, or at least can only do this at greater expense to customers.

We appreciate the Commission providing an illustrative example of its preferred arrangement in Appendix A of its directions paper. This simply assumes that participants, in a situation of reduced firmness of SRD units, will "enter into a subsequent trade… so that both gentailers can exactly manage their risk… without placing the costs and risks of negative IRSR (in net positive cases) on consumers."[3] We expect the Commission's forthcoming discussions with market traders will highlight the fundamental challenges in finding alternative means to manage these risks. At present, the basis risk of inter-regional price differences can only be otherwise mitigated by physically locating supply in the same region as the customers buying energy. Without this option, the likely impact will be for participants to reduce the amount of inter-regional trade, which is critical for regions like South Australia which already have low levels of liquidity and should actually see more trade facilitated by Project EnergyConnect. Means to manage this residual risk may evolve over time but will be imperfect and not transparent, with limited prospects of efficient price discovery. Ultimately this means higher risk premiums that are paid for by customers. Under the Commission's conceptualisation of costs and benefits for customers, this is more than simply a transfer of costs that would otherwise be borne by allocating residues to TNSPs. In making its final determination the Commission needs to be confident that this reallocation of risk will not result in a net increase in costs to customers.

A further point regarding efficient risk allocation is the Commission's apparent view that TNSPs are unable to mitigate the scale or frequency of inter-regional price separation. The AER recently decided to remove incentives on TNSPs under the Market Impact Component of the AER's Service Target Performance Incentive Scheme.[4] This component existed in recognition of the significant effect network outages and congestion have in causing inefficient dispatch and wholesale price spikes. These actions and outcomes also encompass the operation of interconnectors and instances of negative residues. As we and several stakeholders expressed to the AER, we have significant concerns that there

[3] ibid., p. 57.
[4] Review of electricity transmission service standards incentive schemes | Australian Energy Regulator (AER)

is now limited regulatory oversight on TNSP actions and risk of customer detriment, based on what we consider to be a poor understanding of the role of TNSPs in the NEM. The Commission's direction paper seems to similarly overlook how TNSPs may be able to respond to and reduce the risk of large residues accruing. We recommend the Commission give this further consideration in making its final determination. In addition to this, the Commission should consider whether rule obligations on TNSPs to provide timely and accurate data on scheduled network outages are sufficient.

The Commission has not tested the claims by the Energy Networks Australia and TransGrid that accommodating instances of negative residues to TNSPs (including after being allocated 'around the loop' in proportion to demand) would adversely impact debt covenants and credit metrics. TransGrid and ElectraNet previously sought a participant derogation to address their concerns that funding Project EnergyConnect (worth several billion dollars) would similarly cause financeability concerns. These concerns were not substantiated by quantitative assessment.[5] We encourage the Commission to again seek to validate claims by TNSPs with example modelling, noting it is now very late in the consultation process, and should have been done by those making such claims. In the event such exposures are material, a plausible solution (as proposed by TransGrid[6] and by us previously) would be to impose a secondary clamping threshold in light of excessive monthly or annual negative residues. Again we regret that the Commission does not appear to have genuinely considered this alternative and has now left itself limited time to do so.

If you would like to discuss this submission, please contact me on 03 9060 0612 or Lawrence.irlam@energyaustralia.com.au.

Regards

Lawrence Irlam
Regulatory Affairs Leader

[5] Participant derogation – financeability of ISP projects (TransGrid) | AEMC
[6] AEMC settlement residue loop DD p. 3.