INFORMATION

Optional Firm Access: Pricing Report Published

Publication of Pricing Report

Optional Firm Access relates to the coordination of transmission and generation operations and investment. It is intended to contribute to a market that is able to adapt to changing conditions, particularly demand and generation patterns, and therefore deliver better outcomes for consumers. Today the AEMC has published a Pricing Report as part of our project to develop the optional firm access model, and assess the impacts that the model would have on the market.

Background

The National Electricity Market (NEM) is currently experiencing a period of significant change and uncertainty. Changes being observed include in the areas of: policy settings to deliver Government's environmental objectives, growth of local generation, structural changes in the gas section, new patterns of consumption, and technological change.

The AEMC considers that we need resilient and flexible market and regulatory arrangements. The market should be capable of adjusting to change efficiently with respect to price and reliability outcomes in response to whatever the future holds. A market that is able to adapt to changing conditions will deliver better outcomes for consumers.

The optional firm access model is intended to contribute to a market that is able to adapt to changing conditions, particularly demand and generation patterns, to deliver better outcomes for consumers. The optional firm access model is intended to introduce more commercial drivers on transmission businesses, and more commercial financing of transmission infrastructure. This could shift some transmission investment risk away from consumers.

At the same time, optional firm access would better enable generators to signal where they value transmission capacity. Better coordination of transmission and generation investment could minimise the total system cost of building and operating both generation and transmission over time, and so potentially minimise prices for electricity consumers in the longer term.

The COAG Energy Council, through the Terms of Reference, directed the Commission to develop this model in more detail and undertake an assessment of the impacts of implementing it.

The purpose of this report is to provide a progress update on the work the AEMC has done on the access pricing element of the optional firm access model.

Need for efficient price signals

To achieve its aims, the optional firm access model needs to send efficient price signals to generators. Such signals promote more efficient use of the network by exposing generators to the long-term transmission costs associated with their locational decisions. This assists generators in making efficient decisions about where to locate new power stations, or retire existing ones.

We consider prices for firm access should be based on the long run incremental costs (LRIC) created by a generator's decision to locate in a particular part of the network.

While prices for firm access should be reflective of incremental transmission costs, it is preferable to apply a *stylised* methodology which does not capture every aspect of the network and involves some judgements about the future.

Need for efficient price signals (continued)

By assuming away some of the complexity inherent in transmission planning, such an approach would produce smooth and stable outcomes. The price signals produced by this stylised methodology should nevertheless represent an improvement on the current arrangements, where locational signals are minimal.

To achieve its aims, the optional firm access model needs to send efficient price signals to generators.

In addition to the locational signals, the quantum of the prices charged to generators for firm access is also important. If prices do not reflect incremental costs of providing access, generators may pay more or less than the costs their access actually imposes on transmission businesses. If they pay less, for example, consumers may indirectly bear some of the costs of providing the generators with access.

How the prototype pricing model works

We have developed a prototype pricing model which produces access prices for different amounts of access, at different locations, and for defined terms based on the LRIC pricing methodology. In developing it we have had input from transmission businesses and consultants.

At this stage, the prototype pricing model is a work in progress:

- it shows that a model can be developed to produce prices for the different parameters described above;
- the prices produced demonstrate the right relativities, with higher prices for access more remote from the regional reference node or in more congested areas;
- however, we are not yet confident that the model produces prices whose quantum reflects incremental transmission costs.

The quantum of prices generated by the prototype pricing model may not reflect incremental transmission costs due to the following factors:

- the model includes augmentation costs but not replacement costs;
- the model does not accommodate non-thermal constraints (such as stability);
- capacity is always provided by adding new lines, not incremental changes (such as adding a capacitor bank); and
- our cost inputs are limited.

We are working to overcome as many of these factors as possible, however some are a result of our inability to get access to data. **We are therefore publishing the model to seek stakeholder input on how the model currently works. It should NOT be used as a guide to what generators may pay if optional firm access was implemented.** It is also important to bear in mind that if optional firm access was implemented a more comprehensive model would be developed.

Next steps

We will hold two workshops on the pricing model, one on 13 November 2014 in Sydney and one on 14 November 2014 in Melbourne. For more details of these, see our website.

Submissions on this Supplementary Pricing Report are requested by no later than **Thursday, 11 December 2014**. We will incorporate stakeholder feedback as we further develop the model. We intend to release an updated version of the prototype pricing model with our Draft Report in February 2015.

Consistent with the Terms of Reference, we will publish by mid-2015 a Final Report including our final recommendation as to whether or not optional firm access should be implemented, and if so, in what form.

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