

Mr John Pierce
Chairman
AEMC
PO Box A2449
SYDNEY SOUTH NSW 1235



Government
of South Australia
Department of
State Development

Optional Firm Access, Design and Testing First Interim Report (EPR0039)

Dear Mr Pierce

The Energy Markets and Programs Division of the South Australian Department of State Development thank you for the opportunity to comment on the Australian Energy Market Commission's *Optional Firm Access, Design and Testing – First Interim Report* (the Report).

As indicated in our previous submissions to the Transmission Frameworks Review the main area of concern for South Australia is the inefficient locational decisions made by generators which result in congestion on the South Australian transmission network. The development of a framework that provides incentives for generators to locate in uncongested parts of the network is a crucial issue for South Australia, and we therefore continue our support of the Optional Firm Access model.

Further, while I note that the proposed changes are complex and represent a very significant implementation task South Australia would be disappointed if a key reform of this nature, offering potential significant benefits to the market, was abandoned due to the complexities of the task.

I therefore welcome the Commission's work in producing the First Interim Report, and provide the following comments on the various topics raised.

Assessment Framework

South Australia notes the comprehensive list of issues that the Commission plans to investigate under the proposed assessment framework and considers these should provide greater clarification regarding the potential impacts of the optional firm access model. While further information on the proposed long run incremental cost pricing model will be made available at a later date, I note that potentially any inaccuracies in the estimated prices under the model may result in costs being passed on to consumers. While the Commission has stated that they consider that costs passed on to consumers should be "neutral" over time, this issue should be further investigated as part of the assessment process.

While we recognise that the Commission will be attempting to quantify the impacts of the model as much as possible, we note that many of the benefits associated with the proposal will be significantly more difficult to model and quantify than the associated costs. We therefore encourage the Commission to consider the quantitative results of the modelling as only one input into a wider qualitative assessment of the proposal.

Firm Access Standard

South Australia understands that the Firm Access Planning Standard is not a true deterministic standard as the decision to invest is still based on economic decisions made by generators seeking to gain firm access. These decisions will be based on a generator's assessment of the benefits and costs associated with any further network augmentation.

However, South Australia is concerned that Firm Planning Access standard would be expressed in a deterministic manner with it specifying the level of redundancy that the TNSP must build into the network. The Report notes that this would involve the TNSP planning to evaluate the outcomes of a predetermined set of contingencies, without reference to the probability of the contingencies occurring. This could result in relatively high cost solutions to providing firm access such as significant network investment.

The Rules will require that the TNSP provide the level of agreed firm access under a set of specified conditions. The Firm Access Planning Standard should be expressed in a manner that requires the TNSP to meet this standard most efficiently. This may involve relatively low cost operational activities that enable it to meet the firm access planning standard, rather than physically augmenting the network.

TNSP Incentive Scheme

With regard to the revised TNSP incentive scheme proposed in the Report, as the revised firm access operating standard is now proposed to apply under all conditions, South Australia understands why a symmetrical approach has been adopted to reward TNSPs for improving the firmness of access to generators. We therefore regard the exact parameters of the incentive scheme to be an important aspect of the model. The Commission should also give further consideration to how TNSPs will be prevented from manipulating performance in order to obtain a more favourable T-factor or target shortfall level when these are to be set.

Inter-Regional Access

As previously noted, the power transfer capability of the Heywood interconnector between South Australia and Victoria is also often restricted due to voltage and/or thermal limits, depending on transfer direction and the demand and generation conditions in the two states. South Australia is concerned about constraints on the interconnector during periods of high demand in South Australia as this reduces competition by limiting the availability to import Victorian electricity during these periods.

South Australia therefore supports the Commission's proposed approach to long-term inter-regional access. We consider enabling generators and retailers the opportunity to procure inter-regional access rights on interconnectors provides benefits to the market as it should encourage the market-led development of interconnector expansion. It will also be beneficial for generators who operate across regions as it provides a firmer mechanism for hedging the price difference between regions. We therefore encourage the Commission's further work on this aspect of the model.

Short-Term Firm Access

While supportive of the general proposal regarding short-term firm access, we encourage the Commission to further consider the interactions between the incentive scheme and the allocation of auction sales revenue.

South Australia considers that the TNSP should be able to determine how best to utilise any available firm access capacity on its network. In this case the TNSP would need to determine whether firm capacity is required to meet the Firm Access Standard or whether it is available as "spare" capacity. South Australia does not support TNSPs being required to offer any "spare" firm capacity for auction as this would introduce greater complexity and would require a third party to determine what level of capacity should be, or have been, made available to auction.

This approach would encourage the TNSP to operate its network most efficiently and determine if it should undertake discretionary activity. It would allow the TNSP to either maintain this spare capacity to safeguard against potential penalties (or earn potential rewards) in relation to the TNSP incentive scheme, or use it to increase revenues via the short term firm access auctions.

Regarding allocation of auction revenues South Australia considers that any firm access that has been paid for by load customers via TUOS payments, either historically or via load funded expansions, should be returned to consumers through lowering TUOS fees.

An approach which essentially aligns the revenue (either from short-term auctions or the TNSP incentive scheme) to that part of the market that funded the initial capacity would be considered the most appropriate, however would be difficult to implement.

As an example, any short term firm access that is provided by assets funded by customers through TUOS payments should be auctioned as short term firm access with revenue offsetting TUOS charges. This would include:

- legacy transmission capacity that has been developed prior to the commencement of the OFA model;
- a decline in the issued amount of long-term access due to sculpting of transitional access; or
- increased capacity due to network expansion because of reliability standards reasons.

Any short term firm access that is a result of TNSP's undertaking discretionary operational activity should be available for the TNSP to determine the most valuable way for it to utilise this spare capacity. Under these circumstances the short term access auction revenue should be earned by the TNSP.

We therefore consider the most robust option presented by the Commission is where auction revenue from existing capacity is passed through to TUOS users, while auction revenue relating to the additional capacity that can accrue to the TNSP. We note the difficulties associated with distinguishing between additional firm

access capacity that is made available through existing network assets or discretionary spending by a TNSP.

We therefore suggest the fourth option proposed by the Commission where the auction revenue would be split between TUOS users and the TNSP, is a practical solution to this issue.

This option should still provide an incentive on TNSPs to offer short-term access, while at the same time allowing customers to benefit from the offering of short-term access. However, further consideration would need to be given to the exact proportion of the revenue to be assigned to the two parties. An appropriate split would need to ensure that the amount provided to TUOS users adequately reflects past contributions to building of network assets.

Transitional Access

South Australia welcomes the Commission's comprehensive work in looking at the complex issue of allocation of transitional access.

If the approach proposed by the Commission regarding initial allocation is implemented we consider that some balance needs to be adopted between sculpting back the initial access allocation rapidly to ensure the benefits of the model are realised, but also ensuring generators have sufficient time to transition their business operations.

We therefore prefer that some level of intermediate sculpting is implemented. This would ensure the benefits of the model are realised earlier as it would encourage generators to purchase the level of firm access they value sooner than if transitional rights were sculpted back more gradually. It also provides sufficient time for generators to adapt to the new model, adjusting contract positions and dealing with balance sheet impacts.

However, the Commission has noted that a commencement date for the OFA model may not be until around mid-2022, should Ministers agree on any recommendations they may receive in mid-2015. We consider the long lead time associated with implementing the OFA model, should be factored into any sculpting options as generators would be aware of COAG Energy Council's decision to implement the model for a number of years before its commencement. They should therefore be able to tailor contracts, financing etc. knowing that the model is imminent.

While the matters considered by the Commission in the report appear reasonable, the key to the transitional access and sculpting issues will be in the exact sculpting parameters chosen and how this will be determined for each plant.

South Australia is concerned about constraints on the interconnector during periods of high demand in South Australia as this reduces competition by limiting the availability to import Victorian electricity during these periods. We therefore consider that, if the proposal for initial allocation is adopted, the allocation of transitional access should be extended to interconnectors. They should be treated equally to generators for transitional access, with access provided that reflects their historical

use. This would enable firmer access to low cost generation in neighbouring jurisdictions during periods of high demand.

Staged Implementation

South Australia has considered the three high-level implementation options presented by the Commission. Option 1 is considered the preferred approach as all of the benefits of the model would be realised across all jurisdictions. However we recognise that there are significant issues with implementation in this manner, due to the staggered nature of TNSP's regulatory control periods that may result in the commencement of the model being delayed until 2022.

Noting the associated complexities with the simultaneous implementation option, we consider a reasonable compromise could be to commence the model in a staged approach. We therefore consider *Option 2 – Temporal staging* to be the preferred option of the remaining alternatives, as it allows the progressive introduction of the core elements of the model at the earliest possible stage, and therefore the benefits of these elements to be realised as soon as possible.

It also allows for degrees of geographical staging as certain aspects of the model can be introduced in regions where TNSPs have had their regulatory resets, rather than waiting for all TNSPs to undertake resets or introduce mandatory regulatory reopeners as would need to occur in Option 1, assuming the alignment of resets does not occur. The exact nature of the temporal staged implementation, including which elements of the model should be introduced at which stage, can be determined once greater insight is gained on the individual elements following further assessment that will occur during the final stages of the Commission's review.

Further if the Commission determines that it will not recommend proceeding with the implementation of the full model, South Australia would request that the Commission consider implementing aspects of the model rather than recommend doing nothing. Elements of the model that are judged to provide the greatest benefit could be assessed for introduction in the absence of the full model implementation. However, we look forward to reviewing the further work of the AEMC and AEMO before considering this option further.

Reliability Access

We also support the introduction of the Reliability Access mechanism and would encourage the Commission to consider this as a core element of the Optional Firm Access model.

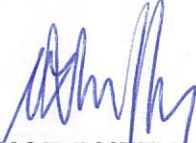
The approach proposed by the Commission to introduce a contingent auction process, with related amendments to the RIT-T process, seem reasonable and would allow benefits to be realised by both consumers and firm access-seeking generators.

Further, we agree with the Commission that the process would need to ensure there are appropriate financial commitments in place by a certain point in time so that generators applying for the firm reliability access would be 'locked in'. Without this

commitment consumers may be left to completely fund the augmentation should a bidding generator withdraw its bid at a late stage. We consider this is a key aspect of the mechanism.

Should you have any questions in relation to this submission, please contact me, on (08) 8226 5500.

Yours Sincerely



VINCE DUFFY
EXECUTIVE DIRECTOR,
ENERGY MARKETS AND PROGRAMS DIVISION

20 / 9 / 2014