



# **Major Energy Users Inc.**

30 April 2015

The Chairman  
Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

Dear Sir

**DRAFT FINAL REPORT  
Optional Firm Access, Design and Testing  
Reference: EPR0039**

The Major Energy Users (MEU) welcomes the opportunity to provide its views to the AEMC on the draft Final Report on Optional Firm Access, Design and Testing (OFA).

The MEU responded to the draft first interim report on OFA and was actively involved throughout the Transmission Frameworks Review process. As it stated in its earlier response, the MEU can see the long term benefits to consumers that the OFA arrangement would bring to the National Electricity Market (NEM). The MEU commented that it saw the OFA starts bring to the NEM some of the benefits of a view the MEU has had for many years - that by generators paying for the costs of transmission will reflect what occurs in competitive markets where producers pay for delivering their products to the wholesale market.

Overall, the MEU considers that the draft final report is very comprehensive and generally provides a workable process for the implementation of the OFA concept. The MEU congratulates the AEMC on this achievement but highlights that there are a few aspects that need further consideration - these are detailed below.

The MEU notes that the draft final report considers that the immediate implementation of OFA is not seen to return sufficient benefits to offset the costs<sup>1</sup> inherent in establishing the OFA and on this basis, the AEMC is of the view that immediate implementation of the OFA does not meet the National Electricity Objective (NEO) although it may well do so at some time in the future. With this in mind, the AEMC recommends that the market be monitored to identify when implementation of OFA will deliver a net benefit. The MEU agrees with this.

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<sup>1</sup> The costs and benefits are identified in the various consultant reports provided as adjuncts to the draft Final Report

## **What happens if the OFA does not get implemented now?**

The MEU sees that OFA would more readily resolve a number of the problems that the NEM currently faces, and this view has been supported by the AEMC in a number of other reviews and proposed rule changes where the AEMC posited that the introduction of the OFA would address concerns raised about market inefficiencies.

One such rule change was the AER proposal on ramp rates where the AEMC commented<sup>2</sup>:

"The Commission notes that such issues [as counter price flows] could be addressed through the Optional Firm Access model currently being considered by the AEMC. Optional Firm Access would delink physical dispatch from financial outcomes in the wholesale market and so align the commercial incentives on generators with the promotion of more efficient market outcomes for consumers".

The MEU notes that the calculation of benefits developed by AEMC consultant E&Y only includes the direct benefits of OFA and does not include the benefits that the AEMC has assumed would accrue when assessing other proposals made to address aspects of market inefficiency. For example, the AEMC considered that the cost impact of counter price flows that the AER identified in its rule change proposal on ramp rates would be addressed with the introduction of OFA yet with the deferral of OFA, these counter price flows can still occur until OFA is implemented.

This means that either the E&Y report should include these other benefits or the AEMC should readdress those earlier decisions where it assumed that OFA would overcome the market inefficiency identified.

The MEU considers the AEMC needs to address this concern.

## **Risks to consumers of OFA**

The MEU notes that the AEMC development for the implementation of OFA makes particular note that the introduction of the OFA should not increase the risks to consumers. The MEU appreciates that this has been done but points out that there is at least one circumstance where consumers would still be at risk.

This occurs where a generator has entered into an agreement with a TNSP for augmentation of the network to ensure that the generator has firm access. Whilst the concept developed requires the generator to continue paying for the augmentation even if it no longer require the firm access, there is an assumption that the generator

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<sup>2</sup> AEMC DRAFT RULE DETERMINATION National Electricity Amendment (Generator ramp rates and dispatch inflexibility in bidding) Rule 2014 28 August 2014, page 14.

will continue its generation operations (see draft final report volume 2 section 7.5) and would still make any payments from its OFA contract.

What the draft final report does not address is where the generator is not able or not prepared to make the appropriate payment after it no longer requires the OFA - such as where the generator is in administration or insolvent. As the draft final report is currently written, under these circumstances, either the TNSP or consumers will have to bear the loss involved.

The MEU considers that consumers should not bear any risk for any shortfall costs from an agreement made between a TNSP and a generator. The MEU considers that if the TNSP considers that it should not bear any responsibility, then perhaps there needs to be an undertaking (such as a bank guarantee) provided by the generator to protect the TNSP from any residual risk of a generator failure to pay.

### **The transitional period**

The MEU agrees that transitional option iii provides a balance between certainty and transparency of the process.

The MEU has concerns about the proposed sculpting of the transition as it considers that the overall duration of the transition is excessive, where existing generators have free firm access rights at current levels for five years and then free firm access rights reducing over the following 10 years at which point all access would be through auctions.

The MEU considers that the overall duration of 15 years is excessive on three counts:

1. The economic life span of most new plant installed by MEU members is usually assessed on the basis of a duration similar to this 15 year period - ie that in assessing the commercial viability of a new investment, most firms would use this duration as the basis for the life of the investment. Indeed, MEU members have seen this is the duration for pay back of an investment typically used by networks when offering to provide connection services and by new generators seeking third party equity investment.

If 15 years is seen as a typical economic investment benchmark, then the MEU sees that the 15 year transition provided to existing generators would cover the bulk of their expected commercial life. This is too long.

2. Applying a 15 year period would be a barrier to new entrant generators as for most of this period, the new entrant generator would be prevented from securing firm access for the bulk of its output. To overcome this, the new entrant would either defer its entry to the market due to the cost of securing firm access, or would be placed at a commercial disadvantage to the existing generator with its "free" firm access rights.

The AEMC has identified that this might be a problem and suggests that the new entrant could acquire firm access from existing generators with these "free access rights" and buying this access via the short term auction. The MEU considers that this concept is flawed on two grounds:

- a. Selling firm access to a new entrant provides the existing generator with an asset that it did not pay for, but is paid for by consumers. If the new entrant would provide electricity at a lower cost than the existing generator then consumers would effectively be paying the existing generator to secure lower electricity supplies from the new entrant. This is not equitable.
  - b. By not releasing its free firm access rights, the existing generator can impose a barrier to the new entrant generator. Again, it must be recognised that consumers are paying for the transmission assets and it is inequitable that the existing generator can disadvantage consumers by preventing firm access to the new competitor generator.
3. As the AEMC is recommending that the OFA process is not implemented until a number of conditions precedent are fulfilled, the commencement date of the "X period" (ie when the allocation of firm but free access rights is made). This means that the new entrants to the market will be even further disadvantaged due to the combination of the period until OFA commences (ie between now and when the "X period" commences) and then the 15 year duration of the sculpting process.

The MEU therefore considers that the 15 year period should commence now so that when the conditions precedent for implementing OFA are fulfilled this allows the practical commencement of the OFA to be at the earliest possible time (ie the impact of the transition period will reduce over time) requiring the existing generators to be aware that their "free" access rights are being eroded from now and that they will need to implement actions to minimise the impact when the OFA starts.

### **How can a consumer benefit from OFA?**

The MEU considers that the OFA should not be set up just to provide an option for generators to secure firm access to the networks - consumers too should be permitted to have exactly the same rights. To a degree, the MEU sees that consumers can already fund augmentations that provide a firmer level of service than they currently enjoy but this is surrounded by caveats.

The principle for end users (as for generators) is that there is probably some capacity in the existing shared network that can be sold as firm by the network and that, if needed, the network can be augmented to overcome any concurrent generation that allows all generation to be dispatched. For end users, the corollary is that the end user

can either pay for augmentation of the shared network so that its peak demand coupled to the demand from other users can be met at all times or the end user can load shed when there is insufficient capacity in the network. Effectively now, end users are load shed automatically when the network has insufficient capacity.

There are two examples where the MEU considers that an end user should be able to contract firm capacity on the shared network and by doing so avoid paying network charges for assets and services that it does not use.

#### Co-location of generation and end user

An end user near a specific generator can strengthen the shared network between the generator and the end user, to the extent that the generator and end user have a "hardwired" connection through the shared network rather than building separate assets. Even when this is done, the end user is still required to pay for network assets that they do not use or require, even when the end user has elected to load shed should the generator it has contracted with fails to generate supplies. The usual assumption is that the end user might implement, rather than use spare capacity on the shared network, is to build separate assets which bypass the shared assets, merely to avoid paying network fees which are considered excessive for the service provided. What is concerning is that the end user would most likely have to spend more on building new assets than its share of the cost of the shared assets that it needs for the simple connection through the shared network between the end user and the generator it has contracted with.

The MEU considers that a generator and an end user should be able to buy firm access on the shared assets that connect the two without having to pay for the use of network assets or other network services that the end user does not require.

#### End users and connection across regions

An end user near a regional boundary pays for network services that are applicable to the region in which it is located. However, the cost of network services in the region adjacent could well be significantly lower than those in its own region, due to generation in the adjacent region being close to the regional boundary. If there is already existing interconnection between the regions on which the end user could access firm capacity, then it is reasonable for the end user to pay network charges related to the adjacent region and then pay for the firm access on the shared interconnector.

The MEU accepts that the end user might use a financial hedge so that it is able to access the spot price in the adjacent region, but it is still liable to pay for the network charges in its "home" region. If an end user is able to buy "firm" access on the interconnector, then it effectively becomes part of the adjacent region network and so is not liable to pay the higher cost "home" region network

charges. This is a more efficient use of network assets and reflects what would occur if nodal pricing was implemented.

While the end user can build a network extension from the adjacent region to its facility, it is inefficient to build new assets when there is more than adequate capacity in the shared network. The OFA permits the network to cost the firm access for the benefit of generators even when this service uses shared assets, so end users should be able to do the same, and in doing so, avoid paying for services that it does not use.

In developing its responses, the MEU highlights that its views are based on looking at the way the proposed implementation of the OFA concept would impact consumers. The MEU has not attempted to examine or provide views on how the OFA might impact on other stakeholders and generators.

We appreciate the opportunity to have provided this input into the current review. Should you wish for amplification of any of the comments provided, we would be pleased to expand on our views.

The MEU is pleased to be involved in this review process and we request that you keep our Public Officer (David Headberry) at [davidheadberry@bigpond.com](mailto:davidheadberry@bigpond.com) aware of future discussion and request for further stakeholder involvement on this review.

Yours faithfully



David Headberry  
Public Officer

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**The views expressed in this document do not necessarily reflect the views of the Consumer Advocacy Panel or the Australian Energy Market Commission. The content and conclusions reached in this submission are entirely the work of the MEU and its consultant**

Major Energy Users, Inc  
Optional Firm Access, Design and Testing  
MEU response to AEMC draft final report