Major Energy Users Inc.

19 October 2020

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

Sent to: AEMC by online lodgement

Dear Commissioners

Coordination of Generation and Transmission Investment
Transmission Access Reform
Interim Report
EPR 0073

Major Energy Users Inc (MEU) is pleased to provide its thoughts on the issues raised in the Discussion Papers for Coordination of Generation and Transmission Investment proposed access model and renewable energy zones.

The MEU was established by very large energy using firms to represent their interests in the energy markets. As most of the members are located regionally and are the largest employers in these regions, the MEU is required by its members to ensure that its views also accommodate the needs of their suppliers and employees in those regional areas. It is on this basis the MEU and its regional affiliates have been advocating in the interests of energy consumer for over 20 years and it has a high recognition as providing informed comment on energy issues from a consumer viewpoint with various regulators (ACCC, AEMO, AEMC, AER and regional regulators) and with governments.

The MEU stresses that the views expressed by the MEU in this response are based on looking at the issues from the perspective of consumers of electricity but it has not attempted to provide significant analysis on how the proposed changes might impact generators, TNSPs and other stakeholders.

The MEU supports better coordination of new generation and transmission investment. In previous submissions to the AEMC on this issue, the MEU has provided its views on various aspects of the changes proposed by the AEMC in generating a Localised Marginal Price (LMP) and then implementing a Financial Transmission Right (FTR) process to allocate the limited access available at points of congestion in the transmission network.

The MEU considers that the introduction of the LMP and FTRs does provide some benefits to the market, in that it provides a mechanism for the better management of congestion

after it occurs when new generation has been added to the market. The assumption made by the AEMC is that generators will not locate where there is the likelihood of congestion occurring as this might result in some, probably incalculable, increase in costs if they do locate where congestion might occur. The MEU is not convinced that this assumption is correct as generators have a number of competing aspects they have to balance, reducing the power of the AEMC approach.

If the new generator has a lower short run marginal cost of production than existing generators located at the point of congestion, this LMP/FTR signal is likely to have a minimal impact on deterring the new entrant. Overall, the MEU has been consistently of the view that the new approach proposed by the AEMC is unlikely to deliver significant benefit to consumers.

The MEU considers that

- The FTR process is extremely complex and is unlikely to deliver the benefits assumed by the AEMC from the analysis carried out by NERA on its behalf. The MEU considers there are a number of significant flaws and unsustainable assumptions in the NERA study and that as a result the benefits identified by NERA are grossly overstated.
- There is little evidence that FTRs will drive new investment in the transmission network and their value dissipates as augmentation assets are provided to relieve congestion, funded by consumers
- In particular, the MEU notes that while NERA considers that their analysis is supported by international experiences, the MEU points out that the NEM rules are significantly different to most other jurisdictions and that the governments involved with the NEM have, and continue to demonstrate, active involvement in the market, creating considerable distortions.
- For example, the Victorian government has used its powers to require AEMO to build new transmission network assets in western Victoria to relieve congestion in the area caused by an over-build of VRE. Similarly, the SA government has provided extreme pressure to ensure the construction of the new interconnector between SA and NSW and the NSW government has intervened in developing a number of new Regional Energy Zones (REZs). The NERA assumptions exclude the effects of government interference such as this, yet the government actions will result in the value of the FTRs falling as these actions relieve congestion.
- Similarly, the NERA assumptions exclude any impact of the normal activities carried out by TNSPs as they build new assets within each region as part of their annual planning processes.

The MEU has consistently been a supporter of the Optional Firm Access (OFA) process developed by the AEMC in 2015 but, equally, the MEU is aware that the AEMC has subsequent to the development of the OFA been opposed to allowing generators to fund transmission augmentation and holding firm access rights to the augmentation they fund. The MEU considers that the OFA is a much more direct process to address generator-caused congestion and allows generators to be able to augment the networks to suit their needs. If they do invest in transmission assets, they should have the right of access to the increase in capacity they fund for the life of the assets they cause to be built. The MEU considers that if they do not have a firm right to the capacity they fund, then investor/generators will not invest in any transmission assets.

The MEU points out that the OFA has significant similarities to the connection of end users to the shared network where end users newly connecting make a capital contribution to the network service provider for the cost of a new connection[1]. While the MEU does recognise there are some differences, a number of issues identified by the AEMC to underpin the LMP/FTR process have been adequately addressed in the AER guideline on customer connections.

The MEU notes that the 2015 review of Optional Firm Access was discontinued because there was seen to be little net benefit from the program, yet only a few years later NERA advises that the benefits are measured in billions of dollars. We accept that there are changes since the OFA benefits were calculated and that the NERA analysis recognises that there has been (and will continue to be) much more generation investment than was forecast for the OFA analysis and that NERA includes for additional benefits that were not included in the OFA modelling.

The MEU is of the view that if the OFA approach was modelled on the same basis as the NERA modelling for LMP/FTR, then the outcomes might be much the same or even greater. But a major difference would be that consumers would be exposed to less risk as they would not be subject to the potential of funding transmission augmentation to relieve congestion whereas the LMP/FTR process leaves this risk very much at the door of consumers.

The NERA cost benefit analysis

The AEMC commissioned NERA to assess the consumer benefit of this new approach and NERA have delivered a report on its cost benefit analysis which concludes there will be a massive consumer benefit through its implementation. However, despite the glowing conclusions by NERA, the MEU remains unconvinced that the process introduced will deliver sufficient benefit to consumers to warrant the cost and complexity of its implementation.

Further, the MEU is very concerned that the new approach will be used by transmission networks, new generators and governments as a tool to drive new transmission investment to de-congest the networks and that consumers will carry the cost of this augmentation.

The MEU is very concerned about the way the transmission system will develop over time (driven by the ISP and TNSPs) and that these “normal” augmentations they seek to build will continue and, based on past performance, include a number of augmentations to relieve congestion. In Victoria already, as noted above, we have seen AEMO augment the western Vic region (WestVic project) at consumer expense to benefit generation subject to congestion, and government direction to support REZs as well as to “decongest” the network. This makes the assumptions inherent in the NERA model to generate likely net consumer benefits highly unlikely.

[1] The MEU refers the AEMC to the AER guideline for customer connections “Connection charge guidelines for electricity retail customers (Under chapter 5A of the National Electricity Rules).

Effectively the NERA assumptions are quite bold as to where new generation might locate and has assumed that transmission investment will be quite limited, whereas the MEU recognises that transmission investment will continue to be as significant in the future as it has in the past.

The MEU notes that NERA only assumes new transmission investment is based on the Priority 1 and 2 projects[2] in AEMO's 2020 Draft ISP going ahead plus the Marinus Link from 2036. The model does not include any of the transmission projects proposed to connect REZ's or projects as set out in TNSP's annual planning reports, all of which are likely to reduce congestion. In this regard, at a recent workshop on dedicated connection assets there was extensive discussion of TNSPs building new connection assets which will address congestion in the REZs. These new augmentations, probably built at consumer expense, will have a major impact of the NERA assumed benefits, yet NERA in its report observes "other" augmentations than those they assume will be built will have only a marginal impact, as the provision of much of the benefit comes from the differences between LMP and RRP, which is congestion driven.

The NERA modelling, regarding the level of optimal generation capacity required to meet forecast needs in the future for both power system security and consumer reliability, is considerably different to the AEMO views detailed in the 2020 ISP. AEMO forecasts that by 2040 a combined total of approximately 100 gigawatts (GW) of installed capacity is required to sustain operation of the NEM where NERA in its reform case suggests only 90 GW of installed capacity is required. Given that the total demand in the NEM is only 40 GW, this 10 GW difference is quite significant.

The MEU notes that there are a number of other assumptions in the NERA modelling which are doubtful

- The cost of gas assumed by NERA significantly impacts the level of benefits identified. The MEU points to the recent advice from the AEMO consultant assessing the gas price for the 2022 ISP shows that the 2020 ISP gas price used by AEMO is no longer valid. NERA should recast its modelling based on the lower gas price forecast for the 2022 ISP
- Residential price index assumptions are inconsistent with the 2020 ISP forecasts
- Storage is not well modelled

A major concern is that the savings identified are concentrated in the last few years of the forecast, where there is the most uncertainty. This factor alone, raises great concerns about the usability of the modelling outcomes.

A further flaw in the NERA work is its assumption about pricing. The wealth transfer, incorrectly determined, assumes that forward contract prices will align with spot price outcomes only where it would be reasonable to expect that forward contract prices will also include the costs of procuring FTR's. Absent covering the costs of FTR's it is unclear why generators (or potentially retailers if generators sell contracts only at their node) would sell or purchase contracts. The additional costs of FTR's will need to be recovered to allow the market to remain balanced. This is the experience of those competing in overseas markets where LMP/FTR's are in place.

[2] Priority 1 and 2 projects are either listed as "committed" or "actionable" by AEMO.

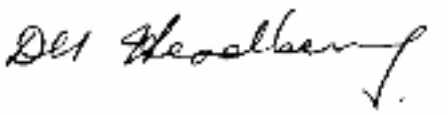
The last work undertaken to estimate the impact of disorderly bidding in the NEM was undertaken in 2018 (less than 2 years ago and well after the massive growth of VRE in recent times) and the calculated impact was seen as being approximately $17M. The NERA modelling indicates a cost associated with disorderly bidding of $170M by 2025, but NERA offers no explanation for this tenfold increase since the last assessment. Further, the planned transmission investment will undoubtedly reduce the potential for congestion and disorderly bidding.

In summary, as an overarching principle we broadly support transmission access reforms that support the efficient and timely capital investment, efficient system operation and reduced costs to consumers. However, the MEU considers the transmission access reforms process as proposed by the AEMC are quite problematical and readdressed as the cost/benefit and impacts on users is not definitive. The proposed shift to Locational Marginal Pricing and Firm Transmission Rights whilst in theory might provide appropriate signals for transmission investment and generation locational signals these may at best be temporal and it is unclear what costs or unintended consequences and risks will impact users in the long run. The purported benefits of this proposed reform appear theoretical, include significant flaws and do not appear to be sufficient enough to justify the inherent risk of implementing the TAR.

In contrast, the MEU considers that a readily available approach to tying transmission and generation investment together is the Optional Firm Access approach which can be readily implemented with few of the detriments in the TAR, but which would probably provide a greater benefit to consumer but at much less risk.

The MEU is happy to discuss the issues further with you if needed or if you feel that any expansion on the above comments is necessary. If so, please contact the undersigned at davidheadberry@bigpond.com or 0417 397 056

Yours faithfully



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