



Hon Lily D'Ambrosio MP

Minister for Energy, Environment and Climate Change
Minister for Solar Homes

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Ms Merryn York
Acting Chair
Australian Energy Market Commission
Level 15
60 Castlereagh Street
SYDNEY NSW 2000

Ref: MBR043125



Dear Ms York

IMPROVING THE TRANSMISSION PRUDENT DISCOUNT APPLICATION PROCESS- RULE CHANGE PROPOSAL

I am writing to notify the Australian Energy Market Commission (AEMC) that, in accordance with Section 91 of the National Electricity Law, the Victorian Government wishes to submit a proposal to amend provisions of Schedule 6A.4 of the National Electricity Rules (NER), concerning the declared network functions of the Australian Energy Market Operator (AEMO).

The proposed rule seeks to make clarificatory and procedural amendments to the way in which an application for a 'prudent discount' to transmission use of system fees would be handled in a jurisdiction where the declared network functions of AEMO apply (Victoria being the only such jurisdiction).

The intent of the rule is to ensure that an applicant for a prudent discount is afforded procedural fairness during the process of their application, that all relevant parties participate in negotiations around such an application, and that the incentives upon AEMO are aligned with the intent of rule 6A.26.1 to avoid 'economic bypass' of the transmission network.

The Victorian Government submits that this change is non-controversial within the meaning of Section 87 of the National Electricity Law, as it merely clarifies and improves procedural aspects of the rules, pertaining specifically to how they are applied in jurisdictions where AEMO has 'declared network' functions, and neither alters the substance nor the intent of Chapter 6A of the NER.

A copy of the proposed rule change and the application to the AEMC is **attached** to this letter.

Should you have any queries in relation to the proposed derogation, please do not hesitate to contact Sarah Sheppard, Acting Executive Director, Energy Sector Reform of the Department of Environment, Land, Water and Planning, on 0428 234 060 or at sarah.sheppard@delwp.vic.gov.au.

Yours sincerely

Hon Lily D'Ambrosio MP
Minister for Energy, Environment and Climate Change
Minister for Solar Homes

10 / 8 / 2020

Encl.

Proposal to amend Chapter 6A, Schedule 6A.4 of the National Electricity Rules

This proposal has been prepared in accordance with the Australian Energy Market Commission (AEMC) document 'The rule change process: A guide for stakeholders' (30 June 2017).

1 Introduction

1.1 Proponent

Name of proponent: The Hon. Lily D'Ambrosio, Minister for Energy, Environment and Climate Change (Victoria)

Address of proponent: Level 16, 8 Nicholson Street, East Melbourne, VIC 3002

1.2 Rule change request

In accordance with section 91 of the National Electricity Law (**NEL**),¹ the Victorian Minister for Energy, Environment and Climate Change (**Minister**) requests the AEMC to make an amending Rule on the basis set out in this proposal.

A draft of the proposed amending Rule is set out at Annexure A.

A mark-up showing the amendments that would be made to the existing rules is set out at Annexure B.

Terms which are defined in the NEL or the National Electricity Rules (**NER**) have the same meaning when used in this proposal.

1.3 Nature of proposed rule change

The proposed amendments to the NER requested in this proposal affect only Schedule 6A.4, which sets out certain modifications to the operation of Chapter 6A in an 'adoptive jurisdiction' (i.e. a jurisdiction which has declared that the Australian Energy Market Operator (**AEMO**) is authorised to exercise the 'declared network functions' described in section 50C(1) of the NEL).²

Currently, Victoria is the only adoptive jurisdiction in which AEMO exercises declared network functions.³ As a result, the proposed amendments would only affect the operation of the relevant parts of Chapter 6A within Victoria. There would be no change to the operation of Chapter 6A within the other participating jurisdictions.

Please note that this proposal is not a request to make a 'jurisdictional derogation' within the meaning given to that term in the NEL.

¹ As set out in the Schedule to the *National Electricity (South Australia) Act 1996* (SA), as implemented by the adopting legislation of the relevant participating jurisdictions; in this case, most relevantly, in Victoria under the *National Electricity (Victoria) Act 2005* (Vic) (**National Electricity (Victoria) Act**).

² See NEL, s 91(7) and (9), which provide that the AEMC may make a Rule affecting the allocation of powers, functions and duties between AEMO and a declared transmission system operator if the Rule is requested by the Minister of the relevant adoptive jurisdiction.

³ National Electricity (Victoria) Act, s 32.

1.4 Non-controversial rule change

The Minister submits that this change is non-controversial within the meaning of section 87 of the NEL, being a 'Rule that is unlikely to have a significant effect on the National Electricity Market'.

As further explained below, the proposed amendments to Schedule 6A.4 of the NER are in the nature of procedural clarifications, which are intended to resolve potential drafting ambiguities and/or to address unintended consequences as to the way in which the procedural aspects of the 'prudent discount' process set out in clause 6A.26.1 of the NER apply within Victoria.

I therefore request that the AEMC applies the expedited rule-making process, as permitted under section 96 of the NEL.

2 Statement of issues

2.1 Background

The prudent discount regime under the NER

Under clause 6A.26.1 of the NER, a Transmission Network Service Provider (TNSP) may agree with a Transmission Customer to charge lower prices for the provision of certain prescribed transmission services, as compared to the prices that would ordinarily apply in accordance with the TNSP's pricing methodology.

The AEMC has previously described the rationale for the prudent discount regime in the following terms:

'The rationale for allowing these 'prudent discounts' is to prevent inefficient by-pass of the transmission network. 'By-pass' in this context refers to:

- *technical by-pass – such as the development of a duplicate transmission line from a power station to a large load; as well as*
- *economic by-pass – such as a decision to not invest in or expand a load or to shut down an existing operation.'*⁴

If a Transmission Customer requests the TNSP to charge that Transmission Customer reduced charges, the TNSP must negotiate in good faith with the Transmission Customer.

If a TNSP agrees to grant a discount, the TNSP may recover up to 70 per cent of the discount amount from other Transmission Customers through charges for either or both 'the adjusted non-locational component' and 'prescribed common transmission services' in accordance with the TNSP's pricing methodology.⁵

A TNSP may recover greater than 70 per cent of the discount amount from other Transmission Customers via either or both of those same categories of charges if:

⁴ AEMC, Rule Determination: National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No 22, 21 December 2006, p. 52.

⁵ NER, cl 6A.26.1(d).

- (a) the discount amount is no larger than necessary to prevent the applicable charges altering the beneficiary's behaviour to the point of adopting the most attractive alternative in place of the course of action the beneficiary would have adopted if no charges were levied; and
- (b) the giving of the discount would not place other customers of the TNSP in a worse position than if the discount was not offered.⁶

If the TNSP agrees or 'proposes to agree' to a discount and wishes to recover greater than 70 per cent of the discount amount from other Transmission Customers, the TNSP may apply to the Australian Energy Regulator (**AER**) for upfront approval to do so.⁷

The modified operation of the prudent discount regime in Victoria

Schedule 6A.4 of the NER modifies the operation of the prudent discount regime described above when applied in an adoptive jurisdiction (i.e. Victoria).

This reflects the unique arrangements applying in Victoria in respect of the operation of the Victorian declared shared network, under which AEMO performs a number of declared shared network functions. In other jurisdictions, the equivalent functions are performed by the relevant TNSP (i.e. the asset owner) itself.

Most relevantly, in relation to the prudent discount regime:

- (a) in Victoria, the power to agree to a discount under clause 6A.26.1 is vested in AEMO, not the relevant declared transmission system operator (**DTSO**) (i.e. AusNet Services Transmission Group Pty Ltd (**AusNet**));⁸
- (b) before AEMO exercises the power to agree to a discount, AEMO must obtain the written consent of AusNet;⁹ and
- (c) AusNet and AEMO must negotiate in good faith whenever either of them asks the other to consider a proposal for the exercise of the power to grant a discount, in a particular manner.¹⁰

2.2 The problem this proposal seeks to address

The modified operation of the prudent discount provisions in Victoria gives rise to some specific procedural challenges which were not envisaged or intended at the time the relevant provisions were drafted.

While these issues are procedural in nature, and can be addressed via minor drafting changes, their impact is important to applicants in practice.

Most notably, Alcoa Portland Aluminium Pty Ltd (**APA**) has made a request to AEMO under clause 6A.26.1 of the NER for a discount in respect of the Portland aluminium smelter (**Portland Smelter**) on three previous occasions, most recently on 29

⁶ NER, cl 6A.26.1(f).

⁷ NER, cl 6A.26.2(b).

⁸ NER, cl S6A.4.2(k)(3)(1).

⁹ NER, cl S6A.4.2(k)(3)(2)(i).

¹⁰ NER, cl S6A.4.2(k)(3)(2)(ii).

November 2016, each of which was unsuccessful. The APA requests revealed the difficulties posed by each of the three procedural issues discussed below.

The Victorian Government notes that a flawed process for negotiating a transmission discount between the three relevant parties (the requesting party, AEMO and the relevant DTSO) may give rise to an inappropriate outcome, notwithstanding the intent of the relevant NER provisions. The problem this Rule seeks to solve is the apparent misalignment of obligations and incentives upon the parties under Schedule 6A.4, which may frustrate the intent of clause 6A.26.1 the NER.

2.3 The proposed amendments and the rationale

The Victorian Government understands that further applications for prudent discounts are likely to be made in the future, including by APA. As APA's Portland Smelter is a major load in the NEM and its future has significant implications for generation investment, transmission configuration, demand response and other matters beyond the operation of the Portland Smelter itself, the Victorian Government considers it important that any application be heard fairly and through a well-executed process that upholds the intent of the NER.

There are three procedural issues and/or unintended consequences which this proposal seeks to address. Each arises either as a result of the Victorian-specific application of the prudent discount provisions or is an issue that is significantly exacerbated when placed within the unique Victorian context.

For each of these three issues, this section sets out:

- (a) a statement of the nature and scope of the issue concerning the existing NER provisions that is to be addressed by the proposed amending Rule;
- (b) a description of the amendment that it is proposed be made; and
- (c) an explanation of the how the proposed amendment would address the issue.

1. There is no obligation on the relevant DTSO to negotiate in good faith with a Transmission Customer who requests a discount, or to provide relevant information needed by that Transmission Customer in order to pursue the request

In the National Electricity Market (**NEM**) jurisdictions other than Victoria, there is a single TNSP which both assesses the request for a discount by a Transmission Customer and is also the asset owner. Information that is needed by that Transmission Customer in order to be able to meaningfully pursue the request is often held by the asset owner. This information might, for example, include information necessary to ascertain the avoidable costs (if any) associated with the Transmission Customer's facility. This information would be necessary for the Transmission Customer to determine whether or not there is a risk of inefficient bypass of AusNet's system.

Under clause 6A.26.1(c) of the existing NER, the TNSP is required to negotiate in good faith with a Transmission Customer who requests a discount.

In Victoria, the obligation under clause 6A.26.1(c) to negotiate in good faith with a Transmission Customer who requests a discount applies to AEMO in its capacity as TNSP (not to the relevant DTSO).¹¹

In addition, AEMO and AusNet are required to negotiate in good faith with each other in respect of a proposal for the exercise by AEMO of its power to grant a discount.¹² However, in the absence of a proposal by AEMO to exercise its power to grant a discount, AusNet's obligation to negotiate in good faith with AEMO is not triggered.

There is no express obligation on AusNet to negotiate in good faith directly with a Transmission Customer who requests a discount (and, thereby, to exchange information such as may be needed by the customer). Given that AEMO can only grant a discount if it has obtained AusNet's prior written consent, this creates a gap in the overall procedural rights of a Transmission Customer requesting a discount in Victoria, compared to those enjoyed by equivalent Transmission Customers in other participating jurisdictions.

To address this issue, it is proposed that an express provision is inserted to ensure that the relevant DTSO is obliged to negotiate in good faith with a Transmission Customer who requests, or proposes to requests, a discount.

For the avoidance of doubt, it is proposed that this is expressly stated to include an obligation to provide the Transmission Customer with such information as is reasonably required by it for the purpose of making its discount request to AEMO.

The proposed form of the new provision is set out in Annexure A and Annexure B (see proposed new clause S6A.4.2(k)(3)(2)(iii)).

2. *There is no obligation on AEMO to provide reasons for refusing to agree to a discount, and no obligation on AusNet to provide reasons for refusing to consent to AEMO giving a discount*

Under the existing NER, there is no express obligation on AEMO or AusNet to provide reasons where:

- (d) in the case of AEMO, it refuses to agree to a discount under clause 6A.26.1(b); or
- (e) in the case of AusNet, it refuses to provide its consent to the discount under clause S6A.4.2(k)(3)(2)(i).

The lack of an express obligation to provide reasons:

- (a) denies the Transmission Customer making the request the opportunity to respond to any adverse information or interpretation of the NER which is held or made by AEMO or AusNet (as applicable);
- (b) makes it difficult for a Transmission Customer whose request is not granted to properly address the reasons for refusal in any future requests

¹¹ See NER, cl 6A.4.1(a) and 6A.4.2(k)(3)(1).

¹² NER, cl S6A.4.2(k)(3)(2)(iii).

and/or to properly avail itself of any dispute resolution processes available under the NER; and

- (c) contributes to a lack of transparency and accountability in the prudent discount process.

To address this issue, it is proposed that an express provision is inserted in clause S6A.4.2(k)(3)(2) to make it clear that, in respect of a discount request made in Victoria, AEMO must provide reasons for any refusal to grant a discount and AusNet must provide reasons for any refusal to provide its consent to AEMO granting the discount.

The proposed form of the new provision is set out in Annexure A and Annexure B (see proposed new clause S6A.4.2(k)(3)(2)(iv)).

3. *There is a lack of clarity as to whether AEMO can propose to agree to a discount on a conditional basis, pending the outcome of an application to the AER for approval in relation to recovery of the discount amount from other customers*

Under the existing NER provisions, as they apply in Victoria, AEMO is entitled to recover greater than 70 per cent of any agreed discount amount from other Transmission Customers if certain criteria are met, and may apply to the AER for approval to do so.

Based on the past experiences of APA in seeking a discount for the Portland Smelter, it appears that AEMO takes the view that it cannot agree to a discount, even on a conditional basis, without having certainty as to the ability to fully recover the discount amount from other Transmission Customers (i.e. it must be certain that the AER will approve the recovery of the full discount from other Transmission Customers before ‘agreeing’ or ‘proposing to agree’ to a discount).

Equally, APA’s past experience indicates that the AER is unlikely to be willing to express a definitive view on whether or not it will grant approval, other than in response to a formal application by AEMO (which cannot occur until after AEMO, with AusNet’s consent, has agreed or proposed to agree to the reduced charges).

The issue is one that, in practical terms, particularly affects Victoria, where AEMO is required to assess the discount request but is not the asset owner, so itself does not have the same economic incentive to grant a prudent discount as might be expected for a TNSP who is also the asset owner.¹³ AEMO, in particular, as a non-profit entity, does not have capacity to take on the risk of not being able to fully recover the revenues forgone through granting a discount. Therefore there is a misalignment of incentives apparent in the way the process unfolds, with AEMO strongly disincentivised to consider granting a discount, even if it may ultimately be prudent to do so.

¹³ The AEMC has previously discussed the nature of the incentive that would ordinarily be expected to exist for a TNSP to negotiate prudent discounts in respect of services provided by certain dedicated assets, being to avoid the commercial ‘stranding’ of assets. See, e.g., AEMC, Rule Determination: National Electricity Amendment (Pricing of Prescribed Transmission Services) Rule 2006 No 22, 21 December 2006, pp. 52-54.

To seek to overcome this impasse, it is proposed that it be expressly clarified in the NER that AEMO's right to apply to the AER for approval to recover more than 70 per cent of a discount from other Transmission Customers is triggered where AEMO 'proposed to agree' to a discount on a conditional basis (i.e. subject to the AER approving recovery of the proposed recovery amount from other Transmission Customers).

The proposed form of the new provision is set out in Annexure A and Annexure B (see the news words proposed to be inserted at clause S6A.4.2(k)(4)).

3 Contribution to the National Electricity Objective

The National Electricity Objective (**NEO**) is set out in Section 7 of the NEL as follows:

'The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to—

- (a) price, quality, safety, reliability and security of supply of electricity; and*
- (b) the reliability, safety and security of the national electricity system.'*

As the AEMC has previously stated,¹⁴ the purpose of the prudent discount regime is to prevent uneconomic bypass of the transmission system. The ability for TNSPs to reduce charges to a Transmission Customer in circumstances where inefficient bypass would otherwise occur directly contributes to efficient use of electricity services and therefore to the NEO. The proposed Rule change will help overcome ambiguities in, and improve the overall procedural fairness of, the process by which these requests for discounts are assessed.

In turn, this can be expected to both:

- (a) improve the efficiency and procedural fairness associated with the conduct of the discount request and assessment process for all parties involved (i.e. requesting party, AEMO and the relevant DTSO), by increasing the clarity as to respective roles of each, and how they are expected to interact with one another, within the unique Victorian transmission context; and
- (b) reduce the likelihood of substantively economically inefficient outcomes, by ensuring that discount requests in Victoria are determined in the manner intended by clause 6A.26.1 of the NER and are not subject to a greater likelihood of being frustrated by procedural barriers than is the case in the other participating jurisdictions.

By removing unintended procedural barriers to the effective operation of the discount assessment process in Victoria, the proposed amending Rule would increase the prospects that future discount requests are decided based on the substantive merits of the case, consistent with the originally-intended policy and economic objectives behind the mechanism which are, themselves, designed to promote

¹⁴ See section 2.1 of this proposal above.

efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers.

4 Expected benefits of the proposed Rule change

The proposed Rule will, if made, clarify the procedural roles and responsibilities of both AEMO, as the 'TNSP' required to assess a discount request, and AusNet, as the DTSO who must consent to AEMO granting a discount in Victoria.

It will also clarify, and improve, the procedural rights of Victorian Transmission Customers who wish to request a discount.

TNSPs and Transmission Customers in jurisdictions outside Victoria will not be affected by the changes (other than, perhaps, to the extent there could be indirect flow-on benefits to the operation of the NEM overall by maximising the efficiency of network operation and pricing decisions within Victoria).

Dated: 10 August 2020

Annexure A – Draft of the proposed rule

National Electricity Amendment (Prudent Discount) Rule 2020 No. ##

1. Title of Rule

This Rule is the *National Electricity Amendment (Prudent Discount) Rule 2020 No. ##*.

2. Commencement

This Rule commences operation on ##.

3. Amendment of the National Electricity Rules

The National Electricity Rules are amended as set out in Schedule 1.

Schedule 1 Amendments to the National Electricity Rules

[1] Clause S6A.4.2 Exclusions, qualifications and modifications

In clause S6A.4.2(k)3(2), insert:

- (iii) the relevant *declared transmission system operator* must negotiate in good faith with a *Transmission Customer* who makes or proposes to make a request under clause 6A.26.1(c), including by providing any information reasonably required by the *Transmission Customer* for that purpose;
- (iv) if AEMO does not agree with a *Transmission Customer* to charge lower prices for *prescribed TUOS services* and *prescribed common transmission services* under clause 6A.26.1(b), or the relevant *declared transmission system operator* refuses to provide its consent under clause S6A.4.2(k)3(2)(i), AEMO or the relevant *declared transmission system operator* (as applicable) must provide reasons for its decision to the *Transmission Customer*.

[2] Clause S6A.4.2 Exclusions, qualifications and modifications

In clause S6A.4.2(k)4, insert:

Clause 6A.26.2(a) applies as if the words “agreed, or proposes to agree (subject to obtaining AER approval under this clause 6A.26.2)” were substituted for the words “agreed or proposes to agree”.

Annexure B – Draft of the rule as amended

Schedule 6A.4 Application of this Chapter to AEMO and declared transmission system operators

...

S6A.4.2 Exclusions, qualifications and modifications

...

(k) Part J (Prescribed Transmission Services – Regulation of Pricing)

Part J applies subject to the following exclusions, qualifications and modifications:

...

3. Clause 6A.26.1 (Agreements for prudent discounts for prescribed transmission services)

Clause 6A.26.1 applies as if:

- (1) the power under paragraph (b) to agree to charge lower prices for *prescribed TUOS services* and *prescribed common transmission services* were vested in AEMO to the exclusion of the relevant *declared transmission system operator*; and
- (2) additional provisions to the following effect were included:
 - (i) AEMO must obtain the written consent of the relevant *declared transmission system operator* before exercising that power;
 - (ii) the relevant *declared transmission system operator* and AEMO must negotiate in good faith whenever either of them asks the other to consider a proposal for the exercise of that power in a particular manner;
 - (iii) the relevant *declared transmission system operator* must negotiate in good faith with a *Transmission Customer* who makes or proposes to make a request under clause 6A.26.1(c), including by providing any information

reasonably required by the *Transmission Customer* for that purpose;

- (iv) if AEMO does not agree with a *Transmission Customer* to charge lower prices for *prescribed TUOS services* and *prescribed common transmission services* under clause 6A.26.1(b), or the relevant *declared transmission system operator* refuses to provide its consent under clause S6A.4.2(k)(3)(2)(i), AEMO or the relevant *declared transmission system operator* (as applicable) must provide reasons for its decision to the *Transmission Customer*.

- 4. Clause 6A.26.2 (Application to *AER* for approval of proposed prudent discount amounts)

Clause 6A.26.2(a) applies as if the words “agreed, or proposes to agree (subject to obtaining *AER* approval under this clause 6A.26.2)” were substituted for the words “agreed or proposes to agree”.

Clause 6A.26.2(k) is not applicable to *AEMO*.