

5 September 2024

Ms Anna Collyer
Chair
Australian Energy Market Commission
GPO Box 2603
Sydney NSW 2001

Project Reference code: ERC0386

Dear Ms Collyer,

Inter-regional settlements residue arrangements for transmission loops

Energy Networks Australia (**ENA**) represents Australia's electricity transmission and distribution and gas distribution networks. Our members provide more than 16 million electricity and gas connections to almost every home and business across Australia.

ENA welcomes the opportunity to make this submission in response to the Commission's consultation paper on the above Rule change request on Inter-regional settlements residue arrangements for transmission loops. ENA welcomes clarity on these arrangements as the various elements of Project Energy Connect (PEC) are commissioned.

The treatment of settlements residue related revenues arising from loop flows is of particular interest to Transmission Network Service Providers (TNSPs). As the consultation paper notes TNSPs have a significant role in the dispersal of settlements residue related cashflows to consumers via transmission use of system (TUOS) charges. Forecasts of Settlements Residue Auction (SRA) proceeds are reflected in TUOS prices which pass the proceeds to consumers. Therefore, consumers receive most of the benefit in the same year that the associated positive residue accrues to the holders of those instruments.

SRA proceeds, while variable from year to year, are reasonably forecastable as the auctions are conducted over the three years preceding the financial year in which the positive residue will accrue. When setting TUOS prices TNSPs will have approximately 80% of results known and thus exposure to intra year volatility is limited.

TNSPs are also exposed to unpredictable negative settlements residue related cashflows. Negative residues are charged to customers via increased TUOS up to two years after they are paid to AEMO by affected TNSPs. Unlike SRA proceeds, negative residues are not able to be reliably forecast for annual TUOS pricing.

Historic justifications for this exposure have focused on TNSPs having robust under and over-recovery mechanisms, high cash flows and assumed inherent financeability. These cashflows have been manageable to date because they have been small relative to TNSP revenue. This is because negative residues are mainly driven by wholesale outcomes and are managed by AEMO via clamping.

Occasionally, negative residue payments arise from system incidents and are very large. To date this has been infrequent and has been managed via available cashflows and, in some cases, through relevant funding facilities. Those funding facilities impose additional costs on TNSPs, and therefore on customers.

This financial exposure and associated cost are currently minimised by the clamping of negative residue events and the fact that these happen infrequently.

However, a number of options in the consultation paper feature the potential removal of clamping of negative residues with the inherent risk of significant increase in the scale and frequency of negative residue events resulting from loop flows. The potential scale of this exposure is significantly greater than has been the case under current arrangements and is potentially a threat to TNSP financeability. The impact on TUOS prices will in turn significantly affect transmission price stability and the ability of transmission customers to forecast and manage their operational budgets. While AEMO's rule change proposal resulted from extensive public consultation, the role of TNSPs in the flow of IRSR related revenues was taken as a given on the basis that the chosen solution would have regard to reducing the unsustainable nature of negative residues on TNSPs' cash flows.

Given the potential impact of unclamped negative residues under some of the options being considered, robust modelling of the impacts on TNSPs' cashflows and financeability must be conducted in assessing the rule change options. If those options involving more material impacts in terms of negative residues are found to deliver greater benefits to consumers, alternative funding arrangements for negative residues would need to be considered to manage the impact on TNSPs' cashflows and, through them, on customers.

More broadly, consideration should also be given to the more dynamic operation of the NEM that will arise from increased interconnector capacity and connectivity across regions as the energy market transitions to rely more heavily on variable renewable energy sources. With the AEMO rule change options, there is a higher risk of market-based negative residues occurring more frequently and resulting in transmission loops. It is crucial that this risk be investigated and quantified by the Commission as large and frequent calls on TNSPs to fund unclamped negative residues will impact the cashflow and financeability of their business operations and impose material transmission price impacts on customers.

ENA has responded to the consultation questions in the Attachment.

ENA looks forward to working with the Commission as it progresses this Rule change request to the draft determination stage expected in December. In the meantime, if you would like to discuss this submission, please contact me in the first instance at the following email address:

dadams@energynetworks.com.au.

Yours sincerely,

A handwritten signature in blue ink that reads "Dom Adams". The signature is stylized with a large 'D' and a long horizontal stroke at the end.

Dominic Adams

General Manager - Networks

Attachment

Question 1: The problem identified in the rule change request

Do stakeholders consider that there is a problem with applying the current rules for managing IRSR to transmission loops, specifically with respect to:

- *clamping negative residues at the current threshold of \$100,000*
- *allocating negative residues to importing regions*
- *allocating positive residues to importing regions (via settlement residue auctions)?*

Maintaining the current practice of clamping of individual interconnectors would substantially reduce the benefits of PEC and deny efficiencies to the market.

However, removing clamping entirely would result in substantial cashflow issues for TNSPs and result in TUOS volatility and in the cost reflective nature of TUOS being substantially undermined.

Question 2: Will the proposed solution address the issue raised by the proponent?

What do you consider success would look like if the issue identified by the proponent was solved? Do you consider that the proposed changes to the rules will solve the problem raised or are there other factors that would have a greater impact?

Success would see:

- Inter-regional loops largely running unclamped while delivering efficient inter-regional trade.
- Limited clamping and net accruals of negative residues around the loop 'sharing the pain' of negative residues across regions.
- The effective mitigation of any adverse effects, such as from negative residues potentially being materially higher and more frequent than they have been to date. This said, the increase would be less dramatic under AEMO's proposed approach than the alternative proposals due to the netting of positive and negative residues in the AEMO proposal.

Question 3: What are your views of the benefits and drawbacks of the proposed solution?

What do you consider will be the benefits and drawbacks, or costs, of the proposed solution? If there are costs, will these be one-off or ongoing? Is there anything the Commission could do in designing the rule that would help to minimise the costs and maximise the benefits?

The proposal is pragmatic but is constrained by the requirement to minimise TNSP exposures to unreasonable levels of negative residues.

The alternative solutions may deliver higher 'in-market' benefits for customers but would also lead to TNSPs facing unsustainable levels of cashflow risk and, accordingly, customers facing significant uncertainty and volatility in TUOS. Alternative solutions would therefore require alternative funding mechanisms to settle TNSPs' open-ended exposures to negative residues.

Question 4: What are your views on these and other alternative solutions?

Are any of the alternative options outlined above, including a continuation of the current arrangements, preferable to the proposed solution in section 3.1? Can you share any other alternative solutions that you think would be preferable and more aligned with the long-term interests of consumers?

Alternative solutions which remove negative residues management via clamping or otherwise are untenable for TNSPs. This is due to the significant increase in frequency and magnitude of negative residues and its associated impact on TNSP cashflow and substantial impact on both the level and cost reflectivity of TUOS when negative residues are recovered from customers up to two years later.

The unpredictable nature of negative residue events would, under the alternative arrangements, mean that historic behaviours could not reliably be used to predict future exposures to negative residues.

If the TNSP's exposure to negative residues was removed, then the alternative proposals may be sustainable and deliver efficient outcomes. This would also allow negative residues to be passed back to market participants contemporaneously with its accrual.

Question 5: Assessment framework

Do you agree with the proposed assessment criteria? Are there additional criteria that the Commission should consider or criteria included here that are not relevant?

The assessment framework must address whether the existing practice of negative settlement residue flowing to customers via TUOS 2 years post event remains appropriate in the face of significantly higher and more frequent negative residue events. While the treatment of positive residues sees the SRA proceeds returned to consumers via reduced TUOS contemporaneously with its accrual, the return mechanism for negative residues substantially distorts TUOS prices two years later. This undermines the regulatory principles driving cost reflective network pricing.

TNSPs have long been exposed to unpredictable intra and inter regional settlements residue related cashflows. Previous rule changes and reviews have justified this exposure by focusing on TNSPs having "robust under and over-recovery mechanisms", high cash flows relative to the exposure and assumed inherent financeability. The scale and timing of negative settlements residue that could potentially arise from the AEMO rule change and alternative options will have a significant impact on transmission price stability and the ability of transmission customers to forecast and manage their operational budgets.

Historically TNSPs have been able to manage exposure due to the relatively small quantum of the residue related revenues relative to TNSP Maximum Allowed Revenues (MAR). And, in the case of Settlements Residue Auction (SRA) proceeds, the significant proportion of the future SRA revenue is known at the time of publication of intra-regional TUOS prices.

It is clear that these arrangements are not sustainable if negative residues are allowed to accrue without aggressive clamping. Robust modelling of the impacts to customers (including transmission customers) of negative residues on TNSPs' cashflows and financeability must be addressed in assessing the rule change options, and alternative methods considered where necessary to manage the associated cost recovery in a sustainable manner and timeframe.