19 September 2024

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

Project Reference code: ERC0391

Dear Ms Collyer,

Improving the cost recovery arrangements of non-network options

Energy Networks Australia (**ENA**) welcomes the opportunity to make this submission in response to the Commission's consultation paper on the above Rule change request on Improving the cost recovery of non-network options. ENA welcomes improved clarity on these arrangements to enable non network solutions and operating costs to be on a more equal basis to capital solutions.

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.

In summary:

- The ENA supports the intent of the rule change request to facilitate the timely negotiation and implementation of network support agreements and thereby reduce the overall costs of electricity to consumers.
- An upfront AER approval process is critical to providing certainty to TNSPs and other stakeholders on cost recovery.
- The AER's decision-making processes must be flexible and reflect the rapidly changing operating environment.
- As a general principle, the cost-recovery framework for all network support agreements (including system security and alternatives to network augmentation) should be aligned to encourage innovative procurement approaches.
- The AEMC should also consider any interactions with the AER's upcoming System Security Network Support Payment Guideline consultation process. ENA has identified some potential implementation issues with the cost recovery framework in the AEMC's Improving Security Frameworks rule and seeks further engagement with the AEMC on this issue.

ENA provides further detail on its response 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 late November. In the meantime, if you would like to discuss this submission, please contact Verity Watson in the first instance at vwatson@energynetworks.com.au.

Yours sincerely

Dominic Adams

GM Networks

Attachment

The ENA's feedback across the key areas of the AEMC's consultation paper are provided below.

Cost recovery uncertainty

Table 1: Summary of AEMC's consultation paper on cost recovery uncertainty

Topic	Summary
Issue	• Initial cost recovery uncertainty: If non-network opex is not included in a TNSPs revenue proposal, the AER assesses non-network expenditure after a TNSP has already entered a network support agreement. This results in higher cost recovery uncertainty for non-network than for network options. • Ongoing cost recovery uncertainty: The AER has an obligation to approve non-network opex if ongoing payment is required under an agreement between a TNSP and a non-network provider. However, there is a degree of uncertainty whether the AER will approve cost recovery in future revenue determination processes where non-network costs differ from expected levels, such as due to contractual terms.
Solution	• Initial cost recovery uncertainty: Introducing a pre-approval process that would enable a TNSP to seek AER approval of non-network expenditure before a TNSPs enters a network support agreement. • Ongoing cost recovery uncertainty: In the pre-approval process prior to entering the network support agreement, a TNSP could seek AER approval of a 'methodology' for adjusting non-network payments over time. The methodology could include aspects of the agreement that could cause the payment profile to change in future regulatory control periods, such as early termination payments.
Benefit	• Support the non-network sector: Lower cost recovery risks would improve bankability and increase the attractiveness of non-network projects. Improvements in the competitiveness of non-network would support the development of a larger range of non-network projects more broadly. • Benefits for consumers: Increased revenue certainty may reduce the overall costs to consumers to the extent that revenue certainty reduces risk premiums and transaction costs for non-network projects.

The ENA supports the AEMC's summary of the cost recovery issues, proposed solutions and its discussion of potential benefits given the consistency with the rule change request. Our further feedback on cost recovery uncertainty is provided below.

The upfront approval needs to provide certainty to all stakeholders

The upfront approval of network support agreements will promote greater transparency and accountability for the services.

To ensure that the TNSP and non-network proponents can proceed to enter into long term agreements with non-network providers, the AER's approval of a methodology should be binding on the AER to minimise regulatory risk in entering these arrangements.

The TNSP will only have certainty over cost recovery if it makes payments consistent with the approved methodology. In each future touch point with the AER (either the annual true up process or future revenue determinations), the AER's decision making should be limited to confirming whether the payments were consistent with the methodology. In the case of an early termination payment, the ENA considers examples of the circumstances in which these payments could be made could be included in the methodology.

Where payments are inconsistent with an approved methodology, the AER can assess the TNSPs' actions and decisions that contributed to those inconsistent payments. To help avoid this occurring, it would be reasonable to allow a TNSP with the ability to apply to the AER to make amendments to an ex-ante determination where there are changes to a payment methodology in a non-network support agreement. This would also help to ensure the AER can consider any proposed changes to a payment methodology before the payments are made which will provide greater certainty to stakeholders.

This approach provides similar cost recovery certainty to that provided for network expenditure related ex-ante approvals, given if the TNSP delivers a network solution consistent with an upfront approval then there is no risk to cost recovery. This structural difference between network and non-network expenditure heightens risks to the efficient delivery of non-network services – and may mean consumers do not experience the benefits of the preferred option from a RIT-T.

How could an AER upfront approval work in the interests of consumers?

For each non-network service, a TNSP would consider through the negotiations with the non-network proponent pricing related to the costs associated with establishment, availability, activation and usage. It would also consider how these payments could change over time due to external factors and potential contingent events.

The main source of variability in these potential costs is likely to be in the usage of the service. Usage in an operational timeframe is largely outside of the TNSPs control as it will be driven by local electricity demand, voltage, AEMO's scheduling engine (i.e. for system strength) or some other event (such as an unplanned outage). One area the TNSP could theoretically have an impact is related to planned outages, which in some circumstances could impact the usage of a service. However, the TNSP is already incentivised through STPIS to efficiently manage the impacts related to planned outages.

Given the lack of active control a TNSP has in usage of the service, providing sign off on a methodology should not expose consumers to inefficient risks. The AER will review the risk sharing that has been developed in the contract in the ex-ante approval before consumers are exposed to these risks. Importantly the TNSP has nothing to gain from payments being higher or lower as they are all made on a pass-through basis. The TNSP should be required to negotiate the price of the service, and the associated methodology, so that it reflects the reasonable costs of providing the service (in the market that exists) to ensure consumer interest is protected.

Cost recovery timing

Table 2: Summary of AEMC's consultation paper on cost recovery timing

Topic	Summary
Issue	• There is currently up to a two-year delay between non-network related costs being incurred and then recovered by TNSPs. This has the potential to cause balance sheet pressure for TNSPs and a more-lumpy cost recovery profile from consumers.
Solution	• A TNSP's network support payment allowance would be updated at the time the AER assesses and approves expenditure towards an NNO project and also if the TNSP

	applies for the allowance to be updated. This would enable NNO costs to be recovered through prescribed transmission services in the same year in which they are incurred.
Benefit	• Aligning payment with cost recovery is likely to reduce balance sheet pressure on TNSPs to the extent this is, or will become, an issue. • There may be benefits in reduced compensation to TNSPs for the time value of money. However, consumers also have a time value of money so this is only a benefit to the extent consumers' time value is below the allowed rate of return at which TNSPs are compensated.

The ENA supports the AEMC's description of the benefits of addressing the cost recovery timing issues. In addition, the ENA notes that the rule change request would align the timing of payments with the provision of the service and would reduce cost volatility for consumers.

In consideration of the potential alignment with the ISF arrangements the ENA has also provided an alternative approach to addressing cost recovery timing. This is discussed in the alignment section further below.

AEMC discussion of costs related to the proposed solution

Table 3: Summary of AEMC consultation paper discussion on costs

Topic	Summary
Costs related to proposed solution	• Ex-ante assessment and approval of a cost adjustment 'methodology' could increase the level of financial risk borne by consumers as: - limited information available to the AER regarding the likelihood/quantum of potential payments - it could be challenging for the AER to make this assessment, if bespoke methodology or novel/unproven technology. • Approved methodologies could develop into an informal industry standard. Although this could reduce transaction costs, such an informal standard may be inappropriate for specific NNO projects and could increase the cost for specific NNO providers, to cover inefficiently assigned risk.

The ENA considers that the risks discussed by the AEMC either already exist to a greater extent now or can be mitigated through design of improved cost recovery frameworks.

The AER should be required to set out in updated guidelines the principles to be followed to ensure efficient outcomes for consumers are achieved in the process of procuring and negotiating non-network services. This will support the AER's ex-ante assessment and achievement of the lowest cost outcome for consumers. AER guidelines should detail the information required by the AER to make its decision on behalf of consumers. Where the AER cannot make a decision on the appropriateness of the arrangements, especially in regard to potential consumer risks, it should not provide the ex-ante approval for the project.

To support innovation, the guidelines should be flexible to allowing innovative approaches and cater for new technologies. For innovation, the AER's ex-ante assessment should also acknowledge that some projects may not pass this process. The concept of 'failing fast' should be welcomed as part of the ex-ante process to encourage innovation. This will allow the TNSP to amend the risk sharing arrangement in response to the AER or pivot to a secondary option if required. This would allow innovation and avoid protracted and lengthy negotiations that inefficiently use resources.

In relation to the AEMC's concerns around the risk of informal industry standards being developed, as noted in Transgrid's rule change request, this is already an issue and reliance on an ex-post assessment exacerbates it. With an ex-ante assessment, there is greater ability to test out new approaches and concepts by providing the ability to set expectations before parties commit to the project – supporting innovation to the long-term interests of consumers.

Alignment of cost recovery frameworks

As a general principle, the ENA supports aligned frameworks for all non-network solutions given it would reduce complexity and administrative burden. However, it will also be important to avoid any potential negative impacts to implementing system strength non-network solutions in the short-term.

We think this requires further engagement between the AEMC, AER and the ENA to establish the appropriate approach to alignment.

Our initial thinking on an aligned framework is set out in the table below.

Topic	Proposed aligned approach to cost recovery frameworks
Initial cost recovery uncertainty	• TNSPs are able to apply to the AER for an ex-ante approval of a proposed methodology for network support payments linked to any non-network solution. • In any subsequent year, the TNSP can seek AER ex-ante approval of any change to the proposed methodology of network support payments, to address situations in which there is a need to make a change to a network support arrangement that impacts the methodology.
Ongoing cost recovery uncertainty	• Any variation between the forecast costs that have been recovered and actual costs incurred will be recovered (or reimbursed) using the existing network support pass through mechanism. Where actuals are: - consistent with an approved methodology, AER must accept pass through - inconsistent with an approved methodology or the ex-ante approval was not used, the AER must make an assessment consistent with the existing network support pass through mechanism to determine whether the costs inconsistent with the methodology should be passed through to consumers.
Cost recovery timing	• The TNSP can estimate all network support payments for the upcoming year on an annual basis and recover through an additive adjustment to prescribed transmission prices. • Expanding this ISF arrangement approach to all non-network options would reduce the admin burden on the AER and ensure consumers can avoid materially unstable price paths – without increasing risks for consumers as all costs will be assessed in the network support pass through mechanism.

The ENA notes it is currently working through the implementation of the ISF cost recovery approach and would like to discuss some potential unintended consequences. There is a potentially material impact on the financeability situation for TNSPs having to manage large volatile cashflows (on a month to month basis and estimated in the scale of $100’s of millions annually), despite the ability to recover forecast costs annually. The ENA seeks further engagement with the AEMC on this issue.

Materiality thresholds

In considering materiality thresholds, the ENA suggests the AEMC consider, given the expected upcoming projects, no materiality threshold. This should be weighed up against aligning with the existing network support pass through arrangements which have no materiality threshold.

No materiality threshold would allow all non-network solution projects to proceed with certainty and not cause pricing issues for consumers. Without this:

- Consumers would be impacted by smaller projects having higher transaction costs or delays due to the TNSP and network support provider negotiations having to consider this avoidable regulatory risk
- TNSPs may experience balance sheet pressure given multiple smaller projects could easily create the same financial impacts as a single ‘material’ project – these financial impacts are likely to flow on to consumers in some form.

Assessment frameworks

Considering the National Electricity Objective and the issues raised by Transgrid, the AEMC proposes to assess this rule change request against three assessment criteria:

- Principles of market efficiency
- Innovation and flexibility
- Principles of good regulatory practice

The ENA recommends that the AEMC consider the addition of emissions reduction as a key assessment criterion. The timely delivery of non-network options can contribute to a reduction in Australia's greenhouse gas emissions.

Links to the RIT-T

ENA considers that while the RIT-T is not the focus of the rule change process, it may be relevant to consider how any ex-ante assessment process interacts with the RIT-T process. Considering how any ex-ante assessment works effectively alongside the RIT-T process will ensure cost recovery frameworks are driving lower costs for consumers. For example, the increased information obtained from the transparent up front approval process may help inform RIT-Ts.

Full cost recovery uncertainty

The AEMC’s consultation paper noted that Transgrid’s proposed solution also explicitly allows for TNSPs to incorporate the costs of obtaining the agreement (i.e. administrative and negotiation costs) in their network support payment allowance. The AEMC note that at present, clause 6A.7.2 of the NER does not explicitly make reference to recovery of these costs.

Regarding the existing clause 6A.7.2, the AER’s guidelines related to this section of the NER (i.e. the Network Support Pass Through Guidelines) note that for pass through arrangements it will decide if these directly related costs will be allowed for pass through on a case-by-case basis. This treatment creates uncertainty and is also inconsistent with the approach to capex where project related costs are capitalised.

Where there is uncertainty about cost recovery, it will provide an incentive to avoid this form of expenditure. Further, to the extent that these costs exist and are not explicitly recovered TNSPs may incur a penalty under the EBSS.

The ENA encourages the AEMC to consider this issue to ensure that there is a full pass through of all directly related and efficiently incurred costs consistent with the way that network solutions are treated. Importantly, pass through should only be provided for where the costs are not already accounted for in the base opex allowance.

Application of proposed solution

The ENA considers that it would be appropriate to allow all non-network solutions to benefit from the solutions considered in this rule change process. We are interested in working this through with the AEMC to identify any issues with non-RIT-T related non-network solutions using these potential improved cost recovery frameworks. Importantly pass through of non-network solutions related costs shouldn't be available where the costs are already funded via another mechanism.

Implementation issue for the Victorian framework

The ENA does not see any additional implementation considerations for this rule change for the Victorian framework (where transmission functions are split between AEMO and the declared transmission system operators (DTSO)). Our reading is that the proposed rule change can operate as intended for revenue determinations applied to DTOs (like AusNet) – noting they will be limited to transmission services to which those determinations apply.