ERM Power Limited
Level 3, 90 Collins Street
Melbourne VIC 3000

ABN 28 122 259 223

+61 3 9214 9333
ermpower.com.au

Thursday, 28 January 2021

Australian Energy Market Commission
Level 15
60 Castlereagh Street
Sydney NSW 2000

Lodged via: https://www.aemc.gov.au/contact-us/lodge-submission

RE: Connection to dedicated connection assets

ERM Power Retail Pty Ltd (ERM Power) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC's) draft determination (the Determination) for the Australian Energy Market Operator's (AEMO's) 'connection to dedicated connection assets' rule change proposal .

About ERM Power

ERM Power (ERM) is a subsidiary of Shell Energy Australia Pty Ltd (Shell Energy). ERM is one of Australia's leading commercial and industrial electricity retailers, providing large businesses with end to end energy management, from electricity retailing to integrated solutions that improve energy productivity. Market-leading customer satisfaction has fuelled ERM Power's growth, and today the Company is the second largest electricity provider to commercial businesses and industrials in Australia by load[1]. ERM also operates 662 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland, supporting the industry's transition to renewables.

http://www.ermpower.com.au
https://www.shell.com.au/business-customers/shell-energy-australia.html

General comments

ERM is generally supportive of the AEMC's preferred rule described in the Determination. The preferred rule:

- appears to achieve the intent of AEMO's original rule change request
- appears superior to both AEMO's proposed rule change, and the 'strawman' model the AEMC put forward during consultation.

This view is based on the concepts outlined in the Determination document, but not the exact changes the AEMC is proposing to make to the National Electricity Rules (NER). To be clear, ERM is not making any comments on the wording of the AEMC's proposed NER changes on the basis that the AEMC will ensure the final wording of the revised NER aligns with the final determination.

During consultation for the Coordination of Generation and Transmission Investment (CoGaTI) Review, ERM has advised that the major barrier to private sector transmission investment is the lack of a framework to allocate property rights to a private sector party that funds transmission infrastructure. This Determination goes some way to achieving this; however, it still falls short of creating the necessary certainty that when a private party funds a network investment, an enduring property right will result. As a result, the AEMC's proposed changes may fail to facilitate the private transmission investment required for efficient outcomes in both generation and transmission.

[1] Based on ERM Power analysis of latest published information.

ERM notes that the AEMC's preferred rule is targeted only at radial network configurations, and in the Commission's view is not intended to replace broader consideration on the most appropriate framework to implement renewable energy zones (REZs). ERM will make a separate submission to the Energy Security Board (ESB) on this matter as part of the Stage 2 REZ consultation. However, for the purpose of the Determination, it is important that 'radial configurations' allow for multi-circuit transmission assets.

In addition to the above general comments, ERM has identified several components of the AEMC's preferred rule that warrant further consideration to improve the certainty required to facilitate private sector transmission investment. The remainder of this submission explores these topics.

The potential for a designated network asset to become a network loop

The AEMC's preferred rule limits designated network assets (DNAs) to radial transmission elements (i.e. they cannot form part of a network loop or meshed network). This makes sense in the context of the proposed access regime, which importantly "is in no way dependent on the introduction of broader access reform". [2] However, it is unclear what would happen if a future proponent (or TNSP) wanted to connect a DNA to a second boundary point with the shared transmission network (or a second DNA that had a different boundary point) such that it formed a network loop or mesh. It is possible to envisage a scenario where doing so could be physically beneficial for the broader system but result in an economic disbenefit to the party(s) that funded the DNA. This eventuality may bring a range of regulatory challenges if it is not considered as part of this rule change process. The AEMC should ensure that the NER:

- provide a mechanism for a DNA to be subsumed into a network mesh or loop (without economically disadvantaging the DNA owners) if this is to the advantage of the broader system
- protect the rights (and/or provide for economic compensation) of DNA owners if a primary TNSP chose to subsume a DNA into a network mesh or loop (e.g. if the ISP identifies this action along its optimal path).

In considering the level of economic compensation payable, the rules should require the Primary TNSP to procure the DNA on "just terms" to reflect the loss of economic property right as opposed to the construction (market) costs only of the DNA. Ensuring this outcome in the rules would remove a significant barrier to private funding of transmission assets. Absent this provision, it is unclear that the AEMC's preferred rule will achieve its objective to promote efficient investment in provision of DNAs, as the funded augmentation could be appropriated by the Primary TNSP at any time to the economic harm of the DNA owner(s).

The 'free-rider problem'

The Determination describes the 'free-rider problem' as:

> *"…generators are reluctant to fund network capacity when there is no guarantee of their ability to use this capacity and when their competitors can use these assets without having contributed to the cost of them".* [3]

The principles for AEMC's proposed third-party access regime (the proposed NER S5.12) partially address the first part of the problem (i.e. protecting the interests of entities already connected to a DNA who have contributed to its funding). However, the second part is only addressed if the DNA is constructed and utilised so that there is no spare transmission capacity and further third-party access is prevented.

If there was spare non-allocated capacity, then a third party seeking access could do so without having contributed to the capital costs, as long as it didn't adversely impact existing connecting parties. This appears to prevent a business model whereby the party(s) providing the funding 'overbuilds' a DNA business in the first instance, with the option to use or sell the spare capacity in the future (e.g. to facilitate additional generation). This business

[2] AEMC, *Connection to dedicated connection assets, Draft rule determination*, 26 November 2020, pp 48
[3] AEMC, *Connection to dedicated connection assets, Draft rule determination*, 26 November 2020, pp 46

model could potentially have system benefits over the long term if it avoided additional costs incurred from upgrading an existing DNA.

To address this, ERM suggests adding a principle to the proposed NER S5.12 that would allow the DNA owner (or the Primary TNSP if acting as their agent) to charge an additional fee to applicants seeking to connect to an existing DNA, proportional to the capacity they would use. This would apply to both generators and loads. The principle (including the allowable size of the fee, and negotiation between the DNA owner and the applicant) would need to be carefully worded to avoid unduly disincentivising third-party access whilst recognising the investment and property rights of the DNA owner. Additionally, it should be clear that only non-allocated capacity, based on the agreement of the DNA owners, is available for contract to a third party.

As per the following extract, the AEMC's preferred rule already provides for this kind of fee to be passed on to the owner of the DNA.

> "*…the NOA must provide for the Primary TNSP to distribute to the owner of the designated network asset… relevant amounts that the Primary TNSP has collected from connection applicants for the connection to the designated network asset in accordance with the access policy*."[4]

Note that this suggestion has been posed in the context of the AEMC's proposed contractual model, whereby new connection applicants deal exclusively with the Primary TNSP and have no contractual arrangement with the DNA owner (as indicated in Figure 7.1 of the Determination)[5]. However, ERM suggests that the AEMC considers whether it is more appropriate for the connection applicant to directly pay the connection fee to the DNA owner (rather than the TNSP collecting it) after bilateral negotiations. Regardless, the provision for payments by a connecting party would apply equally to access for a generating unit or a load.

Development and approval of a third-party access arrangement

The Determination requires each Primary TNSP to develop a standard third-party access policy after public consultation and discussions with the Australian Energy Regulator (AER). The Determination goes on to say that the access policy can "apply different terms to different DNA services or to different components of a designated network asset"[6]. Additionally, the Determination does not appear to allow DNA owners to be involved in negotiations with parties seeking to connect.

ERM is concerned this falls short of a workable framework that removes barriers for private sector DNA investment. We agree that the Primary TNSP should develop an initial nominal network access policy for consultation and lodgement with the AER. However, finalisation of each individual third-party DNA access arrangement should be done in consultation and negotiation with the DNA owner. This would be on the proviso that the DNA owner could not refuse access, cause unreasonable delays, or charge unreasonable fees to the third party if their connection would otherwise comply with the proposed NER S5.12[7]. Further, as discussed above, only the non-allocated portion of a DNA should be subject to third-party access.

The intent of this suggestion is to ensure that the TNSP does not inadvertently allow a third-party connection that disadvantages the DNA owner. In particular, the TNSP should not connect the third party:

- unless there is unallocated transfer capacity available
- at a cost lower than the DNA owner's cost of providing the service.

[4] AEMC, *Connection to dedicated connection assets, Draft rule determination*, 26 November 2020, pp 101
[5] AEMC, *Connection to dedicated connection assets, Draft rule determination*, 26 November 2020, pp 102
[6] AEMC, *Connection to dedicated connection assets, Draft rule determination*, 26 November 2020, pp 83
[7] Which should also be strengthened, as per the next section.

Increased protection of the rights of existing connecting parties

The sixth principle in the proposed NER S5.12 is:

> *"To the extent that the applicant's subsequent connection adversely impacts the access standards, performance standards, power transfer capability or contractual obligations of an existing connecting party, then an applicant for DNA services to an existing designated network asset must provide reasonable compensation to an existing connecting party to that designated network asset."*[8]

This provision should be strengthened so that the new connecting party is required to take action[9] (not just provide economic compensation) such that the access standards, performance standards, power transfer capability or contractual obligations of an existing connecting party is not adversely impacted. In considering compensation for economic loss under principle 6, the final framework must state this is based on the economic loss to an existing connecting party or the owner of the DNA for the duration that this economic loss continued.

System and performance standards

ERM supports the AEMC's view that "the current arrangements for the application of and compliance with system and performance standards (as described in section 5.1.1) will apply to designated network assets".[10] However, the rules framework to achieve this outcome must ensure that the Primary TNSP – in setting the functional specification for design construction and connection of the DNA at the boundary point, as well as operations and maintenance of the DNA – cannot over specify requirements above that it would reasonably impose on itself for another party's construction of a DNA.

Defining the designated network asset power transfer capability

In defining the power transfer capability for a generating unit connected to a DNA, the final rule must specify this as transfer capability to the DNA boundary point and not the simple transfer capability to the transmission network connection point as often specified in network connection agreements by a TNSP.

Selection of the boundary point

The Determination was silent on whether the Primary TNSP or DNA owner would be able to choose the location of the boundary point. In ERM's view, the NER should explicitly state that the party who pays for the DNA (and the Identified User Shared Asset connecting it to the shared network) should be able to choose the location of the boundary point (subject to consultation with the Primary TNSP, who may only refuse a DNA proponent's preferred location based on reasonable technical constraints). This would expose proponents to the benefits and risks of anticipating and avoiding network congestion. In turn, this would help to encourage the most efficient market-driven network investment.

Network operating agreements

The Determination sets out a proposed framework for implementing a network operating agreement (NOA) between the party(s) funding a DNA and the Primary TNSP. In ERM's view, this seeks to allocate all rights to the Primary TNSP as if the DNA was fully funded by the Primary TNSP. ERM his particularly concerned with AEMC's proposal for DNA NOAs to give Primary TNSPs the right to:[11]

- alter, replace or augment the funded network asset
- have unrestricted use of, and access to, the funded designated network asset

[8] AEMC, *Connection to dedicated connection assets, Draft rule determination*, 26 November 2020, pp 82
[9] This could include, for example, restricting generation output.
[10] AEMC, *Connection to dedicated connection assets, Draft rule determination*, 26 November 2020, pp 67
[11] AEMC, *Connection to dedicated connection assets, Draft rule determination*, 26 November 2020, pp 101

- treat the funded network asset as forming part of the Primary TNSP's transmission network in all material respects.

These rights should be determined by negotiation between the party(s) funding the DNA and the Primary TNSP, not automatically vested in the Primary TNSP under the NER. A requirement to cede these rights to the Primary TNSP will impose a barrier to efficient investment in DNAs by parties other than Primary TNSPs. This would result in delays to the efficient provision of transmission services and supply-side options. Such an outcome would be to the detriment of consumers, who may be required to fund these transmission network augmentations as regulated network investments.

Maintaining a designated network asset

Whilst the Primary TNSP should be responsible for the coordination of maintenance activities (including consultation with the DNA owner regarding the specification of maintenance activities), it is unclear why it should also need to be the provider of those activities. The DNA owner should be able to provide contestable maintenance services, with re-energisation of the DNA subject to a standard operating procedure. This would be similar to the requirements for Market Network Service Providers or generators that are able to undertake their own maintenance activities in coordination with a TNSP, but must have an approved operating procedure for re-energising the asset.

Broader transmission access reforms

On multiple occasions, the Determination refers to broader transmission access reforms. One example is:

> *"Until such time as broader access reforms are applied across the shared network as a whole, the Commission considers the type of special access protections contemplated will only be workable on radial transmission elements."*[12]

Statements like this could be interpreted to mean that broader access reforms are a fait accompli. As stated in multiple previous submissions to the AEMC – most recently on 19 October 2020 – ERM does not support the access reforms the AEMC has proposed as part of the CoGaTI consultation.

If you would like to discuss this submission further, please contact Matthew Ladewig, Policy Adviser at mladewig@ermpower.com.au or on 03 9214 9397.

Yours sincerely,

[signed]

Libby Hawker
Senior Manager – Regulatory Affairs
03 9214 9324 – lhawker@ermpower.com.au

[12] AEMC, *Connection to dedicated connection assets, Draft rule determination*, 26 November 2020, pp 47