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Your Ref:	ERC0251
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Mr John Pierce
Chair
Australian Energy Market Commission
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Dear Mr Pierce

Rule change request—Transmission loss factors

Thank you for the opportunity to comment on the transmission loss factors (TLF) rule change requests and the related Australian Energy Market Commission (AEMC or Commission) consultation paper.

We note that the proposed rule changes seek to:

- redistribute the allocation of the intra-regional settlement residue (IRSR) so it applies equally between generators and networks users, and
- change the marginal loss factor (MLF) calculation methodology to an average loss factor methodology.

We recognise the intent of these proposed rule changes is to address issues within the current transmission loss factor framework. As submitted by Adani Renewables, annual changes to MLFs appear to have become increasingly challenging to forecast as a result of evolution in energy markets, particularly from new generators rapidly emerging in very different parts of the NEM compared to the locations of the established generation fleet.

Consistent with the scope identified in the Commission's consultation paper, our primary view of these requests is that they should be considered alongside the discussion, findings and proposals coming out of a range of parallel processes, including the Coordination of generation and transmission investment – access and charging review (CoGaTI review), the new projects transparency rule, and AEMO's review of MLF calculation processes. These activities have significant overlap with this request, so it is important to ensure the outcomes are not contradictory or duplicative.

We also have some concerns about the intent and consequences of these two proposals, particularly the potential primary and secondary impacts of moving to an average loss factor calculation and the redistribution of the allocation of intra-regional settlement residues (IRSR).

At a high level we consider that, given the complexity of these frameworks and the issues identified, it is more desirable to make improvements through the other, more holistic, review and reform processes already in train, than through these isolated proposals.

In the remainder of this submission, we comment briefly on the proposed changes alongside other market reforms and the individual elements of the rule change proposals.

Consideration of the proposed rule amendments alongside other market reforms and reviews

We recommend close consideration of these proposed changes alongside the other options being considered that may address the issues and achieve similar objectives more efficiently.

The combination of these processes (the CoGaTI review, transparency of new projects and AEMO's work on MLFs) could have material implications for:

- the stability and predictability of MLFs, and
- the amount and allocation of IRSR—in particular if the AEMC adopts a dynamic regional pricing model as proposed in the CoGaTI directions paper.

In our view, it is preferable to resolve these fundamental design issues before considering making these isolated rule changes proposed by Adani Renewables. Otherwise, there is a risk that these changes may add complexity for participants and compromise their individual effectiveness.

IRSR allocation redistribution

In our view, it remains appropriate that IRSR continue to be allocated fully to customers because they bear the majority of costs and risks of transmission investment. It is not clear based on Adani Renewable's request that there is sufficient justification to depart from the current approach, or that it would lead to more efficient behavioural or investment responses.

Under the current framework, generators are responsible only for negotiating and funding their shallow connection costs to the transmission network. Beyond this they do not pay for use of the transmission system. In contrast, customers fund the shared transmission network, and they ultimately bear significant risk from inefficient investments that lead to underutilised transmission assets. Generators are also able to manage risks in a number of ways, including through location decisions and hedging instruments.

Further, we expect that Adani Renewables' proposed change to average loss factors rather than marginal calculations would mean that IRSR is likely to be negative more frequently.[1]

The combination of these effects would be that customers face, in combination:

- greater risk of increased TUOS charges to cover negative IRSRs
- lower contributions from positive IRSRs towards TUOS—that is, higher TUOS charges where IRSRs are positive.

We consider that changes to the contribution of IRSRs towards TUOS, if any, should be symmetrical, with the distribution of negative residues allocated in the same way as positive residues.

[1] Customers bear the risk in case negative IRSRs arise, under which circumstances AEMO recovers the additional revenue from the relevant TNSP which in turn recovers the revenue through higher TUOS charges.

MLF calculation methodology

In our view, calculation of marginal loss factors is consistent with the principle of marginal pricing on which NEM settlement is based. That is, settlement prices are determined by the marginal price of the marginal unit of supply required to meet forecast demand. While average loss factors would reduce the financial impact of losses on generators relative to marginal loss factors, it is unclear whether this sends consistent pricing signals with other market settlement mechanisms.

In addition, average loss factors increases the risk that the overall settlement residue balance is negative, in which case the shortfall would be allocated to transmission networks who in turn would collect higher TUOS charges from customers in those instances. In considering the rule change proposal, we recommend the AEMC investigates whether it is possible to estimate the impact of this change.

Other options for change to the transmission loss factor framework

We have also considered the questions the Commission has posed about other elements within the transmission loss factor framework where changes could be made.

In our view, minor or incremental changes to the framework to improve the operation and impact of the transmission loss factor framework could have merit, where assessed alongside the other work being undertaken by the AEMC and others as identified earlier.

We welcome the views of other market participants on these questions in regard to alternative options and consider these views central to the AEMC's considerations when developing the draft determination.

We thank the AEMC for the opportunity to submit on this process and look forward to ongoing involvement in the assessment of this rule change request. If you have any questions about our submission, please feel free to contact Angela Bourke (03 9290 1910).

Yours sincerely,

Paula Conboy
Chair