

1 December 2023

Project Energy Connect Implementation
AEMO

Submitted by email to: NEMReform@aemo.com.au

Dear Sir/Madam

AEC Submission to Project Energy Connect Implementation – Directions Paper

The Australian Energy Council (AEC) welcomes the opportunity to make a submission in response to the Implementation Paper for Project Energy Connect (AEC) Implementation – Directions Paper (Directions paper).

The Australian Energy Council is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. AEC members generate and sell energy to over 10 million homes and businesses and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 per cent emissions reduction target by 2035 and is committed to delivering the energy transition for the benefit of consumers.

Introduction

In economics the theory of the second best (also known as the general theory of second best or the second best theorem) concerns the situation when one or more optimality conditions cannot be satisfied. The economists Richard Lipsey and Kelvin Lancaster showed in 1956, that if one optimality condition in an economic model cannot be satisfied, it is possible that the next-best solution involves changing other variables away from the values that would otherwise be optimal. In essence it means that if you assume a 'perfect world' and introduce policy based on that assumption you will end up with a third best solution. A classic example of this is alcohol prohibition in the USA where it was assumed that if you ban alcohol people won't drink. In actuality, chaos reigned.

Clearly the loop flow created by PEC violates many of the assumptions that underpin efficient despatch. Yet, AEMO appears to assume this away and propose approaches that will yield so called efficient despatch. Whereas when observed through a more practical lens, one may consider approaches that disregard any preconceived ideas that you can obtain efficient despatch and realise this is unfeasible. Then on this basis be prepared to accept a second best outcome as opposed to a third best one. In this context, the micro-slice option is worthy of at the very least rigorous assessment.

As raised in our earlier submission the micro-slice has attractions regarding trading simplicity and consistency with the existing radial interconnector representations. The AEC does not know whether or not this would be a superior approach for dealing with the issues created by PEC because AEMO has conducted no modelling of this approach. Rather, the Directions paper describes it, rebuts it and presents simplified examples of how it would work. The AEC understands that AEMO opposes it because it can produce large net negative residues without a clear funding source. If so, the AEC agrees that would be problematic. However, this concern should be demonstrated through a realistic constraint equation and modelling undertaken to explore the approach and enable comparison with what AEMO is currently proposing.

Chapter 5

1. *AEMO considers the current process is unsuitable and will restrict efficient dispatch. Are there any additional advantages or disadvantages with the current process identified by stakeholders that could apply in the context of transmission loop flows?*

The AEC agrees with AEMO to the extent that some modifications to the current arrangements will be required.

Chapter 6

2. *AEMO considers regulatory precedent requires negative residue management be retained for periods where IRSR is in deficit around the loop, that this be automated as far as possible, and limited to \$100,000 and any accruing negative residues be allocated to the importing TNSP. For these instances, there would not be any reallocation required. Are there any other approaches to negative residue management AEMO should consider?*
3. *In considering the reallocation approach, AEMO considers a sensible method is to allocate negative residues in proportion to the positive residues on the other interconnectors in the loop. AEMO considers it is preferable that an interconnection that is negative not receive a proportion of the positive residues. Do stakeholders agree?*
4. *Do stakeholders consider these approaches to be reasonably robust, irrespective of whether negative IRSR is deducted from the payouts to SRA unit holders?*
5. *Do stakeholders have a different method for the reallocation of negative IRSR that should be considered?*
6. *Which option best meets the guiding principles identified in Appendix A.3? Are the other options that also meet the guiding principles that should be considered?*

The AEC is unconvinced that there is a need to allocate negative residues in proportion with positive residues on the other interconnectors in the loop. Our primary concern is that how IRSRs are managed on the loop retains the utility of SRA units and provides traders with some degree of confidence in the outcome of their purchased units. The Directions paper presents two options and if AEMO is set on some form of reallocation AEMO's proposed approach (reallocating negative residues only) rather than the allocation of all IRSRs approach is preferable.

7. *Should AEMO propose a method that deducts negative IRSR from the payout to SRA unit holders; or reallocates negative IRSR, in proportion to positive IRSR, directly to consumers in the importing regions?*

It is vital to maintain the integrity of SRA units as an inter-regional hedging instrument and this even more pertinent when one considers that the SA NEM region is the most illiquid region from the market's perspective. If an approach is adopted that reduces the utility these SRA units (ie, deducting NSRs from positive SRA unit holders) it will have detrimental market impacts. Furthermore, if their value is diminished it is highly likely that participants will either not purchase them or bid very low prices and this will only further exacerbate the potential risk that TNSPs may face regarding negative SRs. As noted by AEMO:

"If the hedging value of the units is prioritised, (where negative IRSR is not deducted from the positive IRSR distributed to unit holders), managing the cashflow of negative IRSR might become a

more burdensome task than today, where negative IRSR are mitigated in dispatch. AEMO's preliminary view is this cashflow service or function should not be prioritised over preserving the hedging value of the units"¹

From what the understands it supports AEMO's position on this matter in that SRA unit holders do not have negative SRs deducted from them and the current arrangements apply whereby the TNSPs recover their costs from consumers.

8. *What, if any, other factors need to be included when considering the payment for negative IRSR?*

The AEC acknowledges that either under a loop flow or micro-slice approach NSRs are likely to be larger and that this may raise some cash flow concerns for the three impacted TNSPs (ElectraNet, AusNet and TransGrid). In the AEC's view this matter should be addressed in conjunction the AER and the economic regulatory arrangements for TNSPs as set out in Chapter 6A of the NER. For example, the AER could provide the affected TNSPs with an additional allowance their Maximum Allowed Revenue (MARs) to allow them to provision for large settlement residue deficits. This amount could be estimated on a risk-adjusted basis and be a requirement for TNSPs to demonstrate they are using the funds for provisioning.

Chapter 7

While there are no questions in this chapter, the AEC would like to emphasise the importance of SRA unit holders' right to surrender their SRA units. This will ensure they can be confident when they participate in the auctions they can knowing that they will be conducted in good in good faith.

Any questions about this submission should be addressed to peter.brook@energycouncil.com.au or by telephone on (03) 9205 3116.

Yours sincerely,

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¹ Directions paper, p38.