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8 November 2019

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Via electronic lodgement

Dear John

**Discussion Papers: Coordination of generation and transmission investment (COGATI) (Ref EPR0073)**

AusNet Services welcomes the opportunity to make this submission on the Australian Energy Market Commission's (the Commission's) two Discussion Papers issued in October 2019:

- Coordination of Generation and Transmission Infrastructure Proposed Access Model; and
- Renewable Energy Zones.

AusNet Services owns and operates Victoria's electricity transmission network, as well as the electricity distribution network covering the eastern half of the State. There will be significant investment needed in generating and transmission capacity over the next few decades, including in our network areas (e.g. Western Victoria where renewable generators are seeking to connect). Accordingly, our business has a significant interest in the proposed reforms.

AusNet Services supports reforms such as those being considered under the COGATI review that address investment barriers and help improve the efficiency of the investments that will need to be made. We note that delivering on these objectives will require reforms that are not excessively complex or costly.

While broadly supporting these reforms, more immediate actions are needed beyond the COGATI proposals to resolve the existing network constraints and support timely transmission investment, including through actioning the Integrated System Plan.

The Commission has taken useful steps forward in developing the COGATI proposals, particularly in relation to the access reforms. However, the Renewable Energy Zones element of the reforms are not considered to be as well developed.

AusNet Services supports the decision reflected in the latest discussion papers to remove "Transmission planning and operation" from this review. The reforms to support a more sophisticated approach to transmission planning through the implementation and actioning of the Integrated System Plan are the best way to deliver transmission investment that meets the needs of the energy transition. However, we agree with the Commission's observation that information from the sale and operation of the financial transmission rights and locational pricing could be informative for transmission planning.

The Commission will need to confirm that the benefits of the reforms justify the associated costs and work with stakeholders to identify the most suitable timing to commence the new arrangements. As we have raised previously, the timeframe for the COGATI reforms should be integrated with the ESB work program to avoid the need for any re-working of reform design.

As well as offering our own views, AusNet Services has contributed to and supports the Energy Networks Australia (ENA) submissions on each of the Discussion Papers. The remainder of this submission comments on each paper.

## 1. Proposed access model

The proposed access model has two key elements:

- **Changes to wholesale electricity pricing:** To introduce dynamic regional pricing whereby scheduled and semi-scheduled market participants face a locational marginal price, a regional reference price based on volume-weighted average pricing and the inclusion of dynamic loss factors in both of these prices; and
- **Financial risk management:** The introduction of financial transmission rights (FTRs) for market participants.

These are substantial reforms to the design of the National Electricity Market (NEM). AusNet Services supports the intent of the reform, namely to improve the efficiency of utilisation of the transmission grid and the dispatch efficiency of the NEM and to provide a new tool for generators to manage congestion risk, which has been cited as a substantive barrier to new generation investment.

For these reforms to succeed they will need to improve confidence of investors in generation, by increasing their ability to manage market access risk. Ultimately generators and potential investors are best placed to assess whether the reforms will do that. Concerns raised by a number of stakeholders in the early reaction to discussion papers needs to be understood and worked through, with sufficient time made available to the Commission to do this.

As raised in the discussion paper, there are a range of design issues to be resolved. We offer the following comments for consideration.

*Dynamic loss factors:* From an efficiency perspective, AusNet Services supports the introduction of dynamic loss factors and their inclusion in locational marginal prices and regional prices. Separately the Commission has a preference for the FTRs to be capable of hedging against price differences that arise due to losses in addition to congestion. We would refer the Commission to the issues raised in the ENA submission with this proposal, including the concerns that:

- hedging losses in the FTR is not common elsewhere; and
- whether this could have implications for the revenue adequacy of FTRs.

This will be an area requiring further analysis by the Commission.

*What prices do the financial transmission rights refer to?:* The Commission is proposing that FTRs would be available for price differences between: a local price and any regional price; and a regional price and any other regional price. The Commission is not proposing FTRs for the difference between any local price and any other local price. We consider that further input is needed from a range of market participants on this question. As noted in the ENA submission, the number of nodes could be based on what is computationally possible and based on the products that market participants are seeking.

*Distribution network connections*: More clarity is needed regarding the proposed arrangements for generators connected to the distribution network. Differences in the access rights and arrangements between the distribution and transmission networks could result perverse connection decisions.

*Transmission incentive scheme:* AusNet Services supports in principle the proposal to modify the market impact component of the Service Target Performance Incentive Scheme so that TNSPs manage the network in line with when and where capacity is most valued by the market. The proposal that the incentive strength or revenue at risk is maintained at 1 per cent of Maximum Allowable Revenue (MAR) is also supported. However, we look forward to engaging with the future process to develop the necessary detail on the redesign of the scheme.

## 2. Renewable energy zones (REZs)

As noted above, AusNet Services consider that the reform proposals outlined in the REZ Discussion Paper require substantial further development.

The first area which is unclear is the applicability of the proposed facilitation model being developed by the Commission. We understand that the REZ facilitation model would not apply to REZs identified in the ISP, as these would be delivered through the actionable ISP framework. This is an important clarification. As REZs would largely be developed through the ISP framework, as well as potentially through regional planning processes, the facilitation model being developed by the Commission seems to be relevant only to very limited circumstances in which generators seek to fund shared network as a negotiated service.

The second issue requiring clarification is how REZs have been defined for the purpose of developing the facilitation models. We support the ENA's suggestion that it would assist to consider REZ facilitation arrangements separately in relation to:

- REZs which would satisfy a RIT-T and hence be a prescribed service funded by consumers through TUOS – referred to as a Type B REZ in the ENA submission; and
- REZs that may not satisfy a RIT-T but may be sought and funded by the generators as a negotiated service (and hence not funded by consumers) – referred to as a Type C REZ in the ENA submission.

We note that efficient investment in transmission capacity is best supported by developing transmission capacity that would satisfy a RIT-T. However, development of a model that would facilitate generators funding transmission investment for Type C REZs would also be supported.

In relation to Type B REZs (which would go through a RIT-T), facilitation approaches that encourage generators to commit to connecting in advance of transmission investment would be a useful addition to the development process. The 'transmission bonds' mechanisms has previously been suggested as this would provide confidence in the likely utilisation of the transmission assets. The earlier model put forward by the ENA under which generators that purchased bonds would be able to enter an auction to purchase long term hedges is a variant of the transmission bond model. It provides an incentive for generators to purchase bonds, addressing the free rider problem. As the ENA previously noted, this model could work alongside the Commission's proposed new access framework, rather than being applied ahead of the introduction of that framework.

The Commission's preferred model for REZ facilitation (Long term hedges to fund transmission assets) appears to apply in relation to the Type C REZs identified above. However, given the lumpiness of transmission investment in the context of a REZ, the Commission acknowledge that generator interest may not cover the full cost of the transmission capacity and hence that additional funding could be required - whether via government, speculative investment by TNSPs or by customers where the incremental capacity could pass a RIT-T. AusNet Services does not support the proposed model. In line with the ENA submission, our key concerns with the model are:

- Cost recovery risk that would be faced by transmission businesses, particularly given the difference in the life of renewable generation projects relative to transmission projects;
- The impracticality of the proposed outside funding arrangements, particularly speculative transmission investment and the ability of incremental capacity to pass a RIT-T;
- Generator-funded investment in transmission capacity would require the provision of an access right and hence the model involves the use of long-term hedges to incentivise generator investment. This means that in practice this model could not be introduced in advance of the proposed access reforms; and
- The suggestion on p.33 of the REZ discussion paper that "this approach could be extended to other investments in the transmission network other than REZs" appears to contradict the parallel Access Model discussion paper which removes the Commission's previous proposal to link the sale of FTRs and transmission investment.

AusNet Services is keen to engage further on the more detailed design of the reform options.

Please contact Deirdre Rose, Principal Regulatory Economist if we can assist with any queries in relation to this submission.

Yours sincerely,

Tom Hallam
**General Manager Regulation and Network Strategy**