

30 January 2025

Ms Anna Collyer

Chair

Australian Energy Market Commission

GPO Box 2603

Sydney NSW 2001

Electronic Lodgement: ERC0391

Dear Anna,

AEMC Draft Determination Improving the cost recovery arrangements for NNO's

Energy Networks Australia (ENA) welcomes the opportunity to make this submission in response to the Australian Energy Market Commission's (AEMC's) Draft Determination on *Improving the cost recovery arrangements for transmission non-network options*.

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. This submission is on behalf of transmission members.

In summary ENA supports the overarching policy direction of the AEMC's Draft Determination to provide greater cost-recovery certainty and timing flexibility for the use of transmission non-network options. This will provide greater confidence for Transmission Network Service Providers (TNSPs) and non-network alternative providers to enter into efficient long-term agreements that will ultimately benefit consumers. With regards to specific elements of the Draft Determination and Draft Rule, ENA:

- supports the introduction of a new process for TNSPs to apply to the Australian Energy Regulator (AER) to update its network support allowance and for the AER to determine an ex-ante adjustment within a regulatory control period;
- supports allowing the AER to make an ex-ante determination that a TNSP's methodology for determining network alternative support payments will be consistent with the operating expenditure objectives, criteria, and factors and for that methodology to be included as one of the operating expenditure criteria to be considered by the AER when assessing a TNSPs forecast in a Revenue Proposal;
- recommends the AEMC ensure that the scope of network alternative support payments is sufficiently flexible and is not limited to only be an alternative to network augmentation. For example, non-network alternatives may also be identified as viable options to reduce the scope and cost of network replacements;
- does not support the inclusion of eligibility criteria that limit a TNSP's ability to apply for an AER ex-ante determination mid-period, or in the alternative, that any threshold should apply

only to the ex-ante allowance determination and that no threshold should apply to an ex-ante methodology determination; and

- recommends the AEMC review its use of the word 'materiality' throughout the Draft Determination, to avoid inadvertently conflating any eligibility criteria for an ex-ante determination of network alternative support payments with the annual pass-through mechanism for those payments, for which there is no materiality threshold. It also risks confusion with the separate cost pass-through provisions in clause 6A.7.3 of the National Electricity Rules (NER).

In relation to other matters not specifically addressed in the Draft Determination, ENA:

- recommends that the AEMC include a Rules requirement to substantively align, where appropriate, the cost-recovery frameworks for system security and non-system security related purposes. This reflects the practical nature that a single network support agreement could be leveraged for multiple purposes, such as providing a range of power system security services as well as offering an alternative to network investment;
- considers the Rules should clarify that when the AER makes a future ex-ante decision regarding a network alternative support payment allowance in a transmission revenue determination or an annual network support pass-through decision, the AER should be required to have regard to the information reasonably available to the TNSP at the time of entering into the network support agreement; and
- acknowledges that while the AEMC considers the current framework sufficiently allows for recovery of administrative costs associated with network support agreements, ENA considers the AER's Network Support Pass Through Application Guidelines in relation to this point are currently unclear. ENA recommends that the AEMC consider amending the Rules to clarify TNSPs' ability to include and recover the setup and ongoing administrative costs of network support agreements as part of their network support pass-through application process.

ENA provides further detail on key points below.

ENA looks forward to working with the AEMC as it finalises the Rules and with the AER on the Guideline development. In the meantime, if you would like to discuss this submission, please contact Verity Watson (vwatson@energynetworks.com.au) in the first instance.

Yours sincerely



Dominique van den Berg
Chief Executive Officer

Attachment

1. Initial cost recovery uncertainty

1.1. Ex-ante allowance determination

Under the current regulatory framework an ex-ante allowance to pay for non-network alternatives to transmission network investment can only be proposed through a Revenue Proposal and determined by the AER as part of the ensuing revenue determination. This requires RIT-T assessments as well as negotiation and finalisation of any resulting network support agreements to align with the TNSP's revenue determination cycle, which is unlikely to be practicable in many cases.

For any other non-network alternatives that may arise during a regulatory control period, the only cost recovery mechanism currently available is an ex-post assessment after the completion of each regulatory year – that is, after the TNSP has already made network support payments to the network support provider. This creates uncertainty for the TNSP as to whether the AER will allow the cost recovery of the expenditure incurred as part of the non-network solution.

To address this issue, the Draft Determination introduces a new mechanism whereby a TNSP can choose to seek the AER's ex-ante determination to adjust the TNSP's non-network allowance within a regulatory control period.

ENA considers this new ex-ante determination process would be likely to improve the certainty of cost recovery for the initial establishment of new non-network alternatives. For the avoidance of doubt, the AEMC should also clarify that a TNSP can apply for an allowance adjustment even where there is currently no allowance provided.

1.2. Eligibility to access ex-ante allowance determination

However, this improvement in the regulatory framework for non-network alternatives can only be realised if TNSPs are able to access the ex-ante allowance determination process for all relevant new network support agreements¹. The Draft Rule provides that when developing a new network alternative support payment guideline, the AER has discretion to specify eligibility criteria or thresholds that will apply before the AER accepts an application for an ex-ante allowance determination.

ENA acknowledges that the Draft Rule is permissive only and does not require the AER to specify eligibility criteria or thresholds in the guidelines. However, the draft transitional provisions include a set of default eligibility criteria and a threshold that any network support agreement has an expected average annual payment greater than 1% of the unsmoothed revenue in a regulatory year. ENA anticipates that this default 'materiality' threshold in the transitional provision will become an enduring

¹ The definition of network support event excludes "network support payments that are a substitute for a network augmentation where an allowance for capital expenditure in relation to that network augmentation has been provided for in the revenue determination ..."

threshold when the AER makes the new guidelines – similar to what the AER has recently done with its final System Security Network Support Payment Guideline.

The inclusion of an eligibility threshold could act as a barrier to the adoption of non-network options in circumstances where the value of multiple network agreements all fall below the eligibility threshold, but in aggregate may represent a material cost to a TNSP.

The AEMC should also consider the administrative burden on TNSPs in preparing and supporting a network support allowance adjustment application will act as a counterweight against regularly seeking adjustments for minor amounts. That is, the resource cost to TNSPs of preparing an ex-ante application for adjustment will effectively act as a materiality threshold, albeit one that is flexible and will adjust to individual TNSP circumstances.

If TNSPs are not able to access the new ex-ante allowance determination process for all new network support agreements, there is also uncertainty as to whether the annual network support pass-through mechanism allows for the ex-post recovery of the costs associated with the initial set-up of a new agreement – e.g. legal fees, consultants' costs, internal administrative and planning costs.

This uncertainty arises because the NER definitions of a 'network support event' and 'network support payments' relate back to payments made by a TNSP for the provision of network support services. While the AER has stated that it "will consider costs other than network support payments for inclusion in the network support pass through amount, on a case by case basis" the AER's guideline then goes on to state "The costs that can be included are not necessarily related to the implementation of network support contracts, or planning and assessment of network support arrangements." This wording is ambiguous and could mean either:

- Administrative costs related to implementation planning and assessment of non-network options are not costs that can be included in a network support pass through application; or
- The administrative costs that can be included in a network support pass-through application are not limited to the costs of implementation, planning and assessment of non-network options.

For these reasons, the ENA recommends that the AEMC specify that there are no eligibility criteria to seek an ex-ante allowance determination.

2. Ongoing cost recovery uncertainty

2.1. Ex-ante methodology determination

Under the current regulatory framework there is an annual ex-post network support pass-through assessment and true-up process (NER clause 6A.7.2). The process applies whenever the actual amount of network support payments made in a regulatory year is different from the network support allowance for that year. With no materiality threshold to be applied, this means that in most circumstances any year with actual network support payments will trigger an ex-post assessment. This ex-post assessment process will apply to both positive and negative variances.

To provide greater certainty for TNSPs and non-network providers to enter into long term agreements, the Draft Rule introduces a new ex-ante methodology determination process. The intent is that where the AER has determined that a TNSPs methodology for network alternative support payments will be consistent with each of the operating expenditure objectives, criteria and factors, the AER must then have regard to that methodology in any future determinations of an ex-ante network support allowance or annual pass-through to which the methodology relates.

In particular, the Draft Rule provides that any applicable methodology determined by the AER is included in the set of operating expenditure criteria. When assessing a Revenue Proposal if the AER

is satisfied the forecast operating expenditure reasonably reflects the operating expenditure criteria, the AER must accept that forecast expenditure. Through this mechanism a TNSP will have greater certainty that ongoing network support allowances will be determined by the AER as prudent and efficient if those forecast allowances are consistent with an AER-determined methodology.

ENA supports this aspect of the Draft Determination and agrees it will provide for increased certainty of ongoing cost recovery. This in turn will provide greater confidence for TNSPs and non-network alternative providers to enter into efficient long-term agreements that will ultimately benefit consumers.

In reviewing the drafting of proposed new clause 6A.7.2A(a) it appears that an adjustment of a methodology will only bind the AER for the remainder of the regulatory control period in which the adjustment is made. This is because the words “for that Transmission Network Service Provider in respect of any remaining regulatory year of that regulatory control period.” apply to both an adjustment to a network support payment allowance and a methodology. ENA understands the intent is that an AER determination on a network alternative support payment methodology should carry over between regulatory control periods (for example, due to the long-term nature of these non-network alternative arrangements) and recommends that the AEMC review the drafting accordingly.

2.2. Eligibility to access ex-ante methodology determination

Similar to the new ex-ante allowance determination process the Draft Rule provides that when making the new network alternative support payment guidelines the AER may specify eligibility criteria or thresholds that will apply before the AER accepts an application for an ex-ante methodology determination. Again, the transitional provisions provide a default set of eligibility criteria and thresholds that the ENA considers are likely to form a foundation when the AER finalises the new guidelines.

The provision of greater certainty of long-term cost recovery will lower risks to both TNSPs and non-network providers and deliver lower overall costs for the long-term benefit of consumers. In this context the ability of TNSPs to access the ex-ante methodology determination process is arguably even more important than the ability to access the ex-ante allowance determination process. This is because a methodology determination by the AER provides increased certainty for TNSPs and non-network providers on an ongoing basis in the future, whereas an ex-ante allowance determination only increases certainty within the regulatory control period within which the determination is made.

The AEMC highlighted the potential administrative burden on the AER if it were required to assess a large number of applications to adjust network support allowances. While this is undoubtedly a consideration, ENA notes that the preparation and advocacy of such an application is an additional burden on TNSPs. ENA considers this administrative burden on TNSPs can act as a counterweight against the risk of the AER being subject a large number of small value applications.

ENA recommends the AEMC specify that there are no eligibility criteria or thresholds to meet to be able to access the ex-ante methodology determination process. This is necessary to further support the establishment of efficient long-term arrangements for non-network alternatives, as such agreements may have relatively low annual costs in the early years, but grow as demand increases (e.g. with further electrification of industries as they seek to decarbonise). Alternatively, an eligibility threshold should relate to the expected value over the term of the agreement, not just its value in a single year.

3. Clarification of eligibility criteria and thresholds

The Draft Determination makes regular use of the term ‘materiality’ when discussing the eligibility criteria and thresholds included in the transitional provisions. ENA recommends the AEMC to review

the use of the term 'materiality' in this context, particularly when the Draft Rule links this discussion to a threshold of annual network support payments under an agreement exceeding 1% of the unsmoothed revenue for a regulatory year.

This threshold of 1% of unsmoothed revenue is almost identical to the materiality threshold of 1% of MAR specified in the Rules for a TNSP to access the general cost pass-through provisions in clause 6A.7.3. However they have two very different applications:

- If the increase in costs due to a pass-through event is less than the materiality threshold of 1% of MAR a TNSP is unable to seek an ex-post cost pass-through under clause 6A.7.3 and will be unable to recover those increased costs;
- The ex-post network support pass-through under clause 6A.7.2 has no materiality threshold and a TNSP must always seek an ex-post determination of network support costs.

ENA recommends that in the context of a TNSP's ability to apply to the AER for an allowance determination or a methodology determination that the AEMC refer to an 'eligibility threshold' rather than a 'materiality threshold'.

4. Alignment of network support payment guidelines

This Rule change to improve cost recovery arrangements for non-network options (as an alternative to network augmentation) is being progressed soon after the AEMC has made changes to the arrangements for system security support payments through the *Improving Security Frameworks* (ISF) Final Rule. The ISF Rule has introduced the requirement for the AER to make and publish its System Security Network Support Payment Guidelines. This guideline relates to an application to the AER for a determination regarding expenditure on system security support payments or a methodology for those same payments.

This Draft Rule proposes to require the AER to develop an additional guideline – the Network Alternative Support Payment Guideline. The matters to be in this additional guideline are largely identical to that of the System Security Network Support Payment Guideline. ENA agrees this alignment is appropriate given that both guidelines are supporting the use of non-network providers to meet a relevant system security and/or network capability need. Given this direct alignment of the matters to be included in the guidelines, ENA recommends the AEMC reconsider the need for maintaining two separate guidelines. It is likely to be clearer for all stakeholders if there is a single guideline covering all types of network support payments. It may also be administratively simpler and more efficient for the AER to maintain one guideline instead of two.

ENA notes that while the matters to be addressed in the two guidelines are consistent with each other, there is no requirement that the actual content be aligned. Given that both guidelines are intended to support TNSP cost-recovery when contracting with non-network solution providers, ENA recommends the AEMC include a requirement for the AER to consider the need, so far as practicable, for consistency between the two guidelines. Such a requirement should apply whether the AEMC ultimately decides there should be two separate guidelines or a single guideline that covers all types of network support payments.

ENA also considers there would be benefit in requiring the AER to assess a portfolio of network support agreements that in aggregate are used to meet a single identified need. This could include

agreements with different payment structures or payment methodologies to accommodate different technologies deployed to meet the identified need.

5. Other matters not specifically addressed in the Draft Determination

5.1. Scope of transmission non-network solutions

The wording of the Draft Rule ties the definition of network alternative support payments to being a network support service that is an alternative to network augmentation. ENA considers this definition may restrict the adoption of non-network solutions in circumstances where they may provide value to electricity consumers.

In the case of network replacements, the scope and cost of replacement expenditure may be able to be reduced through deployment of a non-network solution. For example, when replacing power transformers that have reached their end-of-life, the number or size of the transformers could be reduced by contracting with a battery energy storage system (BESS). The BESS could be contracted to export electricity across peak demand periods or during a planned or unplanned transformer outage to maintain reliability of supply to consumers at lower cost.

Using network support from a non-network solution during construction may also help to reduce the overall cost of implementing a network solution by providing backup supplies during extended network outages for project construction and commissioning.

These examples relate to reliability of supply or meeting other transmission network technical performance standards but would not necessarily meet the definition of being an alternative to network augmentation. They should also not be treated as power system security services.

ENA recommends the AEMC ensure the scope of the definition of network alternative support payments is sufficiently flexible to cover a broader range of alternatives to investment in transmission infrastructure, not just alternatives to network augmentation.

5.2. Information available to TNSPs

As the decarbonisation of the power system proceeds large, centralised, dispatchable thermal generators are being replaced by more distributed and variable renewable energy sources and storage systems. ENA anticipates an increase in use of network support agreements to ensure customers continue to receive reliable supply of electricity while minimising the need for investment in new or replacement transmission network infrastructure. This may result in TNSPs applying to the AER for adjustments to allowances and revenues, both ex-ante and ex-post, more often and for potentially larger sums than have been to date.

Good regulatory practice would require the AER's assessment of these non-network applications be limited to the information that was reasonably available to the TNSP at the time of deciding on non-network options. To date, the AER has adhered to this principle and has not attempted to second-guess TNSP decision-making as part of its own determination processes.

Nevertheless, with rapid changes in technologies, costs and opportunities for non-network options ENA remains concerned that the application of this principle of good regulatory practice has to be assumed to be applied. The ENA considers this Rule change process provides a good opportunity to clarify that when the AER makes a future ex-ante decision regarding a network alternative support payment allowance in a transmission revenue determination or an ex-post pass-through decision the

AER should only be able to consider the information reasonably available to the TNSP at the time of entering into the network support agreement.

5.3. Recovery of administrative costs

In its submission to the AEMC Consultation Paper, ENA encouraged the AEMC to consider the issue of providing greater certainty regarding the recovery of the necessary and reasonable costs of establishing and administering network support agreements. As the AEMC has noted, NER clause 6A.7.2 does not explicitly make reference to recovery of these costs and at present the AER guidance is that it will decide these matters on a case-by-case basis.

As noted in section 1.2 above the wording in the current AER guideline is that “The costs that can be included are not necessarily related to the implementation of network support contracts, or planning and assessment of network support arrangements.” This wording is ambiguous and could mean either:

- Administrative costs related to implementation planning and assessment of non-network options are not costs that can be included in a network support pass through; or
- The administrative costs that can be included in a network support pass through are not limited to just the costs of implementation, planning and assessment of non-network options.

This ambiguity exacerbates the uncertainty that already exists in the arrangements for network support pass-through applications. Even if the AER were to clarify the wording in the guideline it would remain the case that there is a lack of certainty under the Rules whether prudent and efficient administrative costs can be recovered.

ENA submits that this Rule change presents the opportunity to clarify that prudent and efficient network support agreement administrative costs could be recovered under NER clause 6A.7.2.