

## INTRODUCTION

The Energy Users Association of Australia (EUAA) is the peak body representing Australian commercial and industrial energy users. Our membership covers a broad cross section of the Australian economy including significant retail, manufacturing, building materials and food processing industries. Combined our members employ over 1 million Australians, pay billions in energy bills every year and in many cases are exposed to the fluctuations and challenges of international trade.

Our members are highly exposed to movements in both gas and electricity prices and have been under increasing financial stress due to escalating energy costs. These increased costs are either absorbed by the business, making it more difficult to maintain existing levels of employment or passed through to consumers in the form of increases in the prices paid for many everyday items.

The EUAA welcome this opportunity to make submission to the Renewable Energy Zones Consultation Paper (Consultation Paper) and commend the ESB on their commitment to stakeholder engagement. We also recognise the efforts by the ESB to better coordinate the establishment of Renewable Energy Zones (REZ) in previous consultations in late 2020.

We appreciate the complexity of any reform that seeks to change network access and charging arrangements. In particular, the existing open access regime always looms as an immovable object in the way of reforms that would be in the long term interests of consumers.

However, we are also seeing that demonstrating net benefits and gaining regulatory approval for large transmission assets, including REZ, is becoming more difficult, in part due to the existing regime requiring that consumers carry all costs and risks.

We believe it would be in the best interests of all parties (consumers, renewable energy proponents, networks and governments) to find common ground on a more equitable cost and risk sharing arrangement. If the desire is to see rapid deployment of renewable energy then everyone needs to be satisfied they are being treated fairly and that each party bears risks and costs that are within the power to control.

## MULTIPLE STAKEHOLDERS – COMPETING AGENDAS

Transmission access reform, including the development of a fair and equitable cost and risk sharing arrangement for REZ has been a topic of debate for several years as market bodies, market participants and consumers grapple with a rapidly changing market environment.

As we identify below, the focus of the debate, and therefore the desired outcome of any proposed reform, differs from stakeholder to stakeholder.

- Consumers; facing a significant increase in network costs due to the rapid transition of energy markets (and having already suffered from network “gold plating”), are looking for alternate models of cost recovery and risk allocation. We are seeking a more equitable approach where all market participants pay costs where

they are beneficiaries (or where they have caused a problem) of new investment and carry risks where it is clear they are in the best position to manage them. Consumers also have growing concerns associated with stranded asset risk driven by a combination of fundamental changes in technology and consumer usage patterns and a mismatch of asset lifecycle where 50-year transmission assets are largely being built to connect generation assets with an operational life of 20 years. Under the existing method of cost recovery, consumers bear all of this stranded asset risk.

- Transmission Network Services Providers; facing a significant investment challenge driven by the rapid transition of energy markets and the emergence of the “actionable” Integrated System Plan (ISP) are looking to protect as much of their capital expenditure as possible by including all network augmentation as part of their Regulated Asset Base (RAB). As with consumers, networks too see emerging issues associated with stranded asset risk and the prospect they may be required to write off the residual value of underutilised or stranded assets (as per recent discussion about writing down asset values post so called network “gold plating”).
- New entrant generators having soaked up all available network access while making minimal financial contribution beyond their own connection assets, are looking to continue to gain access to vastly expanded network capacity while avoiding deep augmentation costs that are, in many cases, being driven by the location of new generation in weak parts of the network or where there is no network at all. To be fair, a growing number of new entrant generators are open to part or fulling funding of new transmission (including REZ) provided they are given appropriate, long-term access rights, which we think is a reasonable request.
- Existing generators, regardless of fuel source, are beginning to face significant constraint issues and adverse Marginal Loss Factors (MLF) associated with a transmission network straining to accept new generation in diverse locations. This situation is having a significant negative impact on the financial viability of these generators who, after careful due diligence, find their projects are now being materially impacted by poorly located new entrant generators. Arguments have been made that congestion should be a problem for equity to solve, not customers. However, experience to date points to customers continuing to pay for new transmission to relieve congestion, essentially paying to resolve problems created by others.
- AEMO, are keen to see the “actionable” ISP come to fruition, which includes significant REZ development. The 2020 ISP is a significant piece of work and has the support of governments who seem willing to assist actionable projects so they are built ASAP. From what we have observed, the main game of many market participants is to see congestion solved via the ISP and REZ, which means consumers will end up paying for a regulated transmission solution, which is no different to the current state.
- Governments, either through their concern regarding reliability, consumer prices or to help fulfil ambitious renewable energy targets, want to see the rapid roll-out of new transmission assets. In recent times we have seen state governments identify specific REZ (i.e. NSW Road Map) that appear to avoid normal AER approval processes with cost recovery likely to end up on NSW energy user network bills.

Unfortunately, many of these agendas appear to compete directly with what we would consider to be the long-term interests of consumers. In this environment, genuine sharing of risks and cost across a broad group of market participants is not only warranted but essential.

## **WHAT WE NEED FROM ACCESS REFORM**

### Equitable Cost and Risk Allocation

The existing cost recovery model for regulated assets, including REZ, assumes that society in general is the sole beneficiary of the investment, therefore all costs should be fully socialised. This is reasonable provided all benefits are also fully socialised, which progressively they are not.

The sole purpose of the development of REZ is to facilitate significant new generation, the majority of which is privately owned and operated. These privately owned generators, who have a first responsibility to deliver profit for shareholders, are set to gain significant financial benefit from REZ assets while consumers cover the entire cost and long-term risks associated with this access.

It must be recognised that consumers have no control over where these assets are being located nor do they have any control over the financial viability or operation of these assets, but are currently expected to carry the cost, volume and technology risks associated with these decisions.

To be clear, we are not arguing against the development of REZ's, as they can represent an efficient means of coordinating the market entry of a significant amount of new generation. Likewise, we are not arguing that consumers do not benefit from these investments, but we do reject the notion that consumers are the sole beneficiaries.

Therefore, moving to some form of generator co-contribution is a highly desirable objective and would lead to a fairer outcome for consumers. Generator co-contribution to network assets will have the effect of exposing more of these costs to open markets and competition, which will drive better outcomes for consumers compared to a regulated environment that, despite good intentions to deliver a result that replicates a competitive market outcome, has not always proven to be so. Moving to some form of generator co-contribution will also place some of the long-term asset risk in the hands of those that are in the best position to manage these risks, being the generators and network operator.

We also believe that sharing risks and costs more equitably also leads to more equitable outcomes between consumers; currently specific consumers can take advantage of lower PPA prices while everyone pays for transmission. By allocating risks and costs to new entrant generators means they will absorb these costs and ultimately pass all or part through to the PPA purchaser.

## **ALTERNATIVE APPROACHES TO REZ COST RECOVERY**

We believe there is an opportunity to develop a more equitable approach to costs and risks associated with Renewable Energy Zones (REZ), especially radial REZ.

As we have stated previously, the EUAA are of the view that the risk and significant portion of the capital costs associated with the connection and operation of new transmission assets should reside with those who stand to gain significant financial benefit from them. While consumers may receive some price benefit from the operation of projects located in a REZ or from the development of a new interconnectors, given the fluctuating nature of the energy market these benefits may be fleeting at best.

In the case of REZ's (and the ISP), much of this additional investment is largely driven by a need of new entrant generators to gain access to the National Electricity Market, from which they will gain significant financial benefit. In some cases, these additional investments (including interconnectors) will also help to support state and federal government policies such as the continued roll out of renewable energy and the regional economic benefits that flow.

While it is our objective to share costs and risk more equitable, we recognise that changing the open access regime to facilitate a shared cost arrangement has a range of challenges. Therefore, an easier place to start would be with REZ's.

We believe these REZ related assets, being built specifically for new entrant generators, should be considered dedicated connection assets. We agree with the AEMC position, outlined in their April 2018 Discussion Paper, that there is little justification for the consumers to effectively subsidise new entrant generators selling into the NEM.

As the AEMC has rightfully pointed out in previous CoGaTI consultations:

“Under the transmission framework, as amended by the TCAPA Rule from 1 July 2018, the assets associated with REZ's would most likely be considered dedicated connection assets and identified assets that are required to connect a group of generators to the shared transmission network. In other words, these assets would be considered connection assets, providing connection services, and so would be paid for by the connecting party/is (i.e. generators).”<sup>1</sup>

In light of this, we offer the following alternative approaches to REZ access and charging. We recognise that these, or variants of these, are being considered as part of this Consultation Paper.

We also welcome the recent AEMC initiative of considering a model which would enable new entrant generators to fund designated network assets which would then be subject (or protected) by a special access regime.<sup>2</sup> While still a small step, it appears to be a step in the righty direction.

### Optional Firm Access

We see a model that would allow generators to purchase a dispatch right (or firm access) to a new REZ as a reasonable step forward. The revenue paid by the purchase of these dispatch rights would be used to offset the costs associated with the REZ. Other generators may still wish to connect into the REZ and not purchase dispatch rights but they would run the risk of being constrained. Alternatively, they may see investment in large scale storage as a better long-term strategy than purchasing a dispatch or access right.

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<sup>1</sup> AEMC Discussion Paper, Coordination of Generation and Transmission Investment: Page 56

<sup>2</sup>[https://www.aemc.gov.au/sites/default/files/documents/connection\\_to\\_dedicated\\_connection\\_asset\\_draft\\_determination](https://www.aemc.gov.au/sites/default/files/documents/connection_to_dedicated_connection_asset_draft_determination)  
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This would change the way in which transmission and generation investment decisions are made, and would mean generators would bear the cost and risk associated with REZ investment and potentially encourage innovation in storage and dispatch. The costs associated with the purchase of these rights would be recovered from customers via a competitive market rather than a regulated pricing framework, which should always be the goal.

While this approach is more workable for a radial REZ we do not see why it could not be applied, at least to some degree, to a meshed REZ although the extent of the access right would need to be established (i.e. how deep does the access right extend?)

A further variation we had considered, which is largely representative of Option 3 in the Consultation Paper, would be to apply locational marginal pricing to the REZ. This would establish sub-regional pricing but only for new REZ, not the entire market therefore avoiding the significant transitional issues being raised by stakeholders. Generators would have access to their locational marginal price (or REZ nodal price), but would also be able to purchase FTR's to manage congestion risk. Essentially, this would be the AEMC Access Reform model (LMP and FTR) scaled down to REZ. Many will see this as a "stepping stone" on the path back to the transmission access model proposed by the AEMC.

If we had confidence this approach would be contained to REZ it may still be worth considering in the context of getting a better outcome for consumers as part of this particular reform. However, the EUAA is still concerned about the impact of applying this reform to the broader market, in particular the potential negative transitional impacts on energy users. Additionally, we are yet to be convinced of the purported consumer benefits of the broader reform.

#### Generator Transmission Use of System Charges (GTUOS)

Currently, only customers pay TUOS and in doing so bear all the costs and risks associated with transmission augmentation. We think it would be highly beneficial to look at ways of distributing TUOS across a broader group of participants, i.e. generators. At first this could apply to new REZ developments where new entrant generators connecting to the REZ pay a share of TUOS associated with their generation output, in some. This could cover all or part the costs associated with the REZ.

As these GTUOS charges would make up part of the generators overall cost base, this approach would have no impact on the operation of wholesale markets and would not require any change to existing RIT-T or cost recovery approaches by TNSP's. It would also send strong price signals to new entrant generators about the overall cost and efficiency of asset location.

GTUOS could also be applied more generally to the NEM where existing TUOS charges could be divided between customers and generators who are both using the shared transmission assets.. If existing shared networks need to be upgraded then either:

1. New entrant generators who have created the need for the transmission augmentation pay a higher GTUOS charge for a period of time (i.e. 15 years). This avoids any issues associated with existing generators cross-subsidising new entrant generators access to the market and would be more aligned with the causer pays principle.
2. The increased GTUOS is shared across all generators.

GTUOS is a significant change to the allocation of TUOS and would increase the costs (and potential risks) of generators, although these costs would be recovered via the wholesale electricity market. No doubt there be transitional issues such as the impact on existing contracts so a long glide path would be required (i.e. AEMC access reform contemplated a 5 year glide path).

However, there are significant advantages to this approach. Importantly, GTUOS would be less likely to be impacted by the existing open access regime as it would be competitively neutral given all generators are treated equally and may not necessarily require the allocation of access rights. Unlike other reforms in this area it does not materially alter the operation of the NEM or add additional AEMO costs as existing wholesale market operations would continue as normal.

GTUOS effectively splits the revenue stream for TNSP's into two groups, but it would remain regulated under the AER. Therefore it would likely mean that TNSP's will maintain a risk level that would continue to attract low cost capital and could also allow a smoother path for ISP projects to be delivered. A GTUOS model would also allow for governments to provide direct financial assistance to transmission projects, allowing a reduction in overall TUOS charges paid by both generators and consumers.

Under GTUOS consumers will end up paying for a majority of transmission but it has the advantages of taking a large portion of the costs out of the regulated environment, where all costs and risks are borne by consumers and have them reflected through the wholesale market.

Therefore, a significant amount of transmission costs will be exposed to market forces (without increasing TNSP risk) meaning consumers will have more confidence in the efficiency of prices they finally pay. It also puts some of the risks and costs directly onto generators, particularly new entrant generators, making them more responsible for the decisions they make while encouraging supply side technical and operational innovation.

We urge you to consider this approach as part of both the REZ reform and also as a longer-term solution to fairer access reform.

### **CONSULTATION PAPER OBJECTIVE 3 – REDUCE THE LEVEL OF RISK AND COST BORNE BY CONSUMERS**

We are pleased to see the ESB recognising the concerns expressed by consumers with a series of measures proposed in this Consultation Paper. While these measures do not remove all costs and risks they do begin the process of re-alignment of cost and risks and propose some worthwhile safeguards to help avoid overbuilding of network infrastructure. We see these as a step in the right direction but also believe more should be done over time.

With these qualifications in mind, we support the concept outlined on page 30 of the Consultation Paper

*“Customers representatives have challenged the notion that they should bear all the costs of transmission investment, particularly where the purpose of the investment is to connect new generation. The ESB’s initial view is that the REZ coordinator could be required to:*

- *provide information to transmission planners to enable them to assess whether the transmission investment associated with future REZ stages should proceed*
- *return net auction revenue to customers.*

*The effect of these proposals is that generators would make a competitively determined contribution toward the cost of REZ transmission assets, but customers would bear the residual risk of underutilisation within a REZ stage.*

While consumers would still bear residual “stranded asset risk” and this is still a concern, and would rely on net auction revenue actually materialising, there is at least a chance of a reasonable contribution to REZ cap-ex from connecting generators, which is an improvement on what we are faced with now.

This is identified as an issue on page 31 of the Consultation Paper:

*“From a customer’s perspective, this approach may be a substantial improvement on the status quo because customers currently bear all the costs of prescribed transmission services. However, it would not provide certainty regarding the proportion or quantum of costs to be allocated to generators. If the REZ tender process yielded lower than expected revenues, then customers would receive a smaller discount on their TUOS.”*

This issue could be partly addressed through application of an auction reserve expressed either as a fixed dollar amount or percentage of REZ capital cost (i.e. 20%). Alternatively, application of both a fixed annual charge plus a variable charge associated with auction revenue could be considered. Neither of these are novel concepts. Auction reserves are standard practice to ensure minimum value for the vendor while customers currently pay a series of fixed and variable charges on the monthly utility bills (electricity, gas, water, sewage etc).

The objective here is to ensure promoted benefits of this reform actually materialise for consumers. It will also help to ensure only genuine players participate in the auction process, removing those who may seek to game the process by gathering up cheap access only to “re-sell” access at a later time.

In regard to auction revenues and their relation to the RIT-T framework. We do not believe auction revenues should be removed from the RIT-T assessment (i.e. they should not be used to off-set capital for the purpose of net benefits assessment of the REZ). The REZ still needs to deliver net benefits regardless of co-contribution from generators as we expect these contributions will still find their way back to consumers, either via a PPA prices or wholesale market.

We are also supportive of the concept of a staged approach to REZ design and construction, which would reduce the risk of overbuilding transmission assets. Similarly, linking the development of the next stage (or subsequent REZ in the region) to the success of the preceding REZ, also helps to reduce some level of stranded asset risk.

### The PIAC REZ Model

Regarding the PIAC REZ model. We encourage the ESB to continue to keep this option open as we believe it does have merit and has the potential to deliver material benefits to consumers. We note the ESB observation on page 32 of this Consultation Paper that:

*“The ESB notes that AEMC’s discussion paper on REZs did not recommend the PIAC model on grounds that it would be susceptible to the current problems arising from the open access regime.*

*To mitigate this issue, the PIAC model could be applied in conjunction with one of the REZ access options outlined in the Chapter 4.”*

We would encourage further discussion and analysis of this proposal.

Once again, we greatly appreciate the effort by the ESB to engage with stakeholders on such a complex issue and we look forward to engaging further on new approaches to equitable cost and risk sharing.



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