

25 FEB 2014



Mr Matt Zema
Chief Executive Officer
Australian Energy Market Operator
GPO Box 2008
MELBOURNE VIC 3001

**Transmission Frameworks - Detailed Design and Testing of an
Optional Firm Access Framework**

Dear Mr Zema

I am writing to you in my role as Chair of the Standing Council on Energy and Resources (SCER) about investigating detailed design and testing of an optional firm access framework as proposed in the Australian Energy Market Commission's (AEMC's) Final Report of the *Transmission Frameworks Review*, published on 11 April 2013.

On 25 July 2013, you and the former Chief Executive Officer of the AEMC, Mr Steven Graham, provided SCER's Senior Committee of Officials (SCO) with a detailed joint proposal for further work on the design and testing of an optional firm access framework.

SCER considered the proposed joint project plan for further work on optional firm access, including the proposed delineation of responsibilities between the AEMC and the Australian Energy Market Operator (AEMO). Accordingly, I am writing to provide you with the scope and details of AEMO's component on this further work on optional firm access, including how it fits within the broader work program.

The purpose of the proposed optional firm access work program, is to build on the work undertaken by the AEMC in its *Transmission Frameworks Review*, set out in Table 10.1 of the AEMC's final report, by developing, testing and assessing an optional firm access framework to inform SCER on whether there are long term benefits associated with implementing the developed optional firm access framework and, if such benefits are identified, develop the optimal approach to the implementation of the framework. This work should assist governments and industry participants to better understand the potential costs, benefits and risks of implementing optional firm access from both an individual and market-wide perspective.

SCER asks that AEMO undertake this work in accordance with the terms of this letter and the work program at **Attachment 1**, in collaboration with the AEMC and in line with the governance structure at **Attachment 2**.

AEMO should work in conjunction with the AEMC to provide to SCER, and subsequently publish, a final coordinated package of work on the design, testing and assessment of the optional firm access framework by mid-2015.

The package of work should be provided to SCER two weeks prior to publication. You are requested to provide updates at each SCER meeting in conjunction with the AEMC on progress and, as soon as practicable, advise on any significant emerging issues that arise in between regular reports to SCER meetings over the course of the project.

SCER appreciates the cooperative approach between the AEMC and AEMO and looks forward to receiving regular updates at its meetings as the design and testing proceeds.

I have provided a copy of this letter to Mr Pierce.

Yours sincerely



Ian Macfarlane

Chair

Standing Council on Energy and Resources

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Attachment 1 – Work program for the detailed design and testing of the OFA model and the development of an implementation plan

Overall Objectives

- Recommend to the Standing Council on Energy and Resources (SCER) whether to implement the optional firm access (OFA) model, and if so, how it could be implemented. Any recommendation in favour of staged implementation will include a ready-to-implement proposal for the first stage, including a specification for any systems changes and a draft rule change proposal.
- In determining whether to recommend the implementation of OFA, the work program will determine whether implementation of OFA is likely to contribute to achievement of the National Electricity Objective.
- Confirm or modify the design of the critical elements of the OFA model as a result of testing. Develop and test a functional design of the necessary elements, specified to a sufficient degree to allow implementation as a next step.
- Engage with industry participants to build understanding of the operation and effects of the OFA model. Assist governments and industry participants to better understand the potential impacts - one-off and ongoing costs, benefits and risks - of implementing OFA. As a guiding principle, this work needs to enable industry participants to make a good estimate of what OFA would mean for their business.

Guiding Principles

- The work will build on the extensive work already undertaken by the AEMC as reflected in Table 10.1 from the Final Report for the *Transmission Frameworks Review* (the Review), which sets out core, recommended and optional elements of the model.
- SCER's expected deliverables, as set out in the covering letter relate to the delivery of the final report and interim reporting measures. Within this broad requirement, AEMO and AEMC will agree on each organisations' specific deliverables which they will each progress to meet agreed timeframes.
- Each organisation will work under its own governance framework to deliver on its responsibilities.
- The work programs will be coordinated so as to ensure consistent outcomes and the AEMC and AEMO will each consult with the other regularly during the work, and seek to agree on matters that affect the deliverables of the other.
- The AEMC and AEMO will establish suitable stakeholder engagement mechanisms to support their work. Matters that have not previously been consulted on through the Review warrant an additional degree of stakeholder consultation – for instance, the feasibility and desirability of staging OFA implementation.
- The AEMC and AEMO will report on a regular basis to SCER and officials. Reporting to SCER will be every six months in the lead up to each SCER meeting; that is, mid-2014 and end of 2014 with a final package of reports to be delivered two weeks prior to the SCER meeting in mid-2015. The AEMC and AEMO are requested to bring to SCER's attention immediately any significant issues that emerge outside the regular reporting schedule.

Specific questions to be answered by AEMC and AEMO

<p>Questions to be answered by AEMC</p>	<p>Questions to be answered by AEMO</p>
<p>1) Does testing and further design work confirm the design of the critical elements of the OFA model?</p> <p>2) What is the functional design of critical elements of the OFA model?</p> <p>3) Is implementing OFA likely to contribute to the achievement of the NEO?</p> <p>a) Assess potential areas of impact, which may include:</p> <ul style="list-style-type: none"> i) improvements to efficiency from reduced incentives for disorderly bidding; ii) improvements in efficiency in the longer term driven by the signals on generation and transmission investment; iii) outcomes on contracting behaviour, risk allocation and commercial outcomes; iv) impacts on inter-regional trade and competition of creating a firmer inter-regional access product; and v) impacts on price volatility in the wholesale market. <p>b) Identify one-off and ongoing costs and risks.</p> <p>4) What is the optimal implementation plan, including consideration of temporal and geographical staging?</p> <p>a) Develop a feasible set of implementation options, including the basis for allocating access rights.</p> <p>b) Assess the most efficient implementation option, including impacts of progressing in some jurisdictions ahead of others.</p>	<p>1) What is the functional design of the access settlements system consistent with the AEMC's design parameters?</p> <p>a) What design variations would be necessary to allow a staged implementation of OFA?</p> <p>b) What design variations would be necessary to allow staged implementation of OFA in some jurisdictions or regions ahead of others?</p> <p>2) What are the impacts of implementing the access settlements system?</p> <p>a) How do these change under different options for staged implementation of OFA?</p> <p>3) What is the implementation plan for access settlements, as agreed with the AEMC and reflecting the most efficient option for staged implementation?</p>

The work that AEMC and AEMO will carry out

In order to answer the questions assigned to them, the AEMC and AEMO will each undertake work programs and stakeholder engagement models under their own governance and funding regimes. Inevitably, there needs to be flexibility for the work programs and engagement models to evolve as results emerge to inform the direction and focus of further work. The following is a list of the key work program elements based on current expectations. The table aims to capture some of the key sequencing and interactions in the work program. It is expected that the AEMC and AEMO will engage with each other and provide input across the entire program.

Key elements of the AEMC work program	Key elements of the AEMO work program
<ul style="list-style-type: none"> ● Develop a decision framework based on the NEO that is relevant to OFA. The decision framework will then be used as the reference point for subsequent design and assessment work in the project, for recommending to SCER whether to implement OFA, and for the recommended implementation plan. Consideration would be given to: <ul style="list-style-type: none"> ○ the commercial, contracting and financial outcomes for all market participants; ○ whether all aspects of the market - policy and economic, commercial and financial, engineering and operational - are considered and aligned; ○ how well the implementation plan works to give time for the industry and market agencies to build understanding and internal capabilities without incurring undue operational or financial risks; and ○ the degree to which existing jurisdictional differences in transmission arrangements would affect transition to OFA. 	
<ul style="list-style-type: none"> ● Confirm or modify the design of the following critical elements of the OFA model as a result of analysis and testing, in accordance with Table 10.1 from the Final Report for the Review: <ul style="list-style-type: none"> ○ access products ○ firm access standard ○ transitional access ● Establish, in consultation with AEMO, candidate allocation methodology(s) for use by AEMO in modelling work. 	
<ul style="list-style-type: none"> ● Confirm or modify the design of the remaining critical elements of the OFA model as a result of analysis and testing, in accordance 	<ul style="list-style-type: none"> ● Develop the candidate design(s) for access settlements consistent with the AEMC's design parameters, ensuring practicability of the

<p>with Table 10.1 from the Final Report for the Review:</p> <ul style="list-style-type: none"> ○ access agreements ○ access pricing ○ revenue regulation and TNSP incentives. 	<p>AEMC’s design. The candidate design will identify any resulting changes to other NEM arrangements such as the settlements residue auction (SRA) and associated instruments.</p> <ul style="list-style-type: none"> ● Develop modelling techniques to estimate the likely benefits of implementing a first stage of the OFA framework where access had been allocated but there was no capacity for participants to purchase additional access. <ul style="list-style-type: none"> ○ As a part of this work, test market outcomes that would have occurred for a past period of time, had access settlement been in place during that period. ○ From the modelling results, estimate the system impacts of the option(s), taking guidance where appropriate from the decision framework. ● Consider what adjustments might need to be made to the candidate design to allow implementation in some jurisdictions or regions initially and for others to opt in later – e.g. specific changes to the SRA or to the allocation of rights to interconnectors.
<ul style="list-style-type: none"> ● Develop and test a functional design of the model’s critical elements, specified to a sufficient degree to allow implementation as a next step – i.e., to allow rules to be written, business processes defined, agreements drawn up and IT systems specified, depending on the element. Incorporate the outcomes of AEMO’s work program. 	<ul style="list-style-type: none"> ● Develop a detailed functional design and proposed draft rule change proposal with justification under the NEO to implement stage 1.

<ul style="list-style-type: none"> ● To provide a baseline for assessing whether different staged implementation options provide an efficient transition to full OFA: <ul style="list-style-type: none"> ○ confirm the principles for allocating transitional access; ○ consult stakeholders; and ○ perform an initial allocation of transitional access. 	
<ul style="list-style-type: none"> ● Carry out an impact assessment of the overall OFA model to inform a recommendation on whether to implement it or portions of it, with reference to the OFA decision framework (see row 1). Relevant outcomes of AEMO's work program (right) will be incorporated. <ul style="list-style-type: none"> ○ To the extent necessary, bespoke modelling or economic experiments might be utilised by the AEMC to inform design decisions or the impact assessment. 	
<ul style="list-style-type: none"> ● Develop a feasible set of implementation options for assessment, including: <ul style="list-style-type: none"> ○ implementing the settlement aspects of the OFA model, with an initial allocation of transitional access but no means for generators to procure new firm access, before rolling out the remainder of the OFA model; ○ implementing OFA in some jurisdictions first. ● Consult stakeholders on staged implementation. 	
<ul style="list-style-type: none"> ● Assess the most efficient implementation option having regard to: <ul style="list-style-type: none"> ○ practicality; ○ the extent to which the option achieves, delays or dilutes the efficiency benefits that OFA is designed to promote; ○ an indicative consideration of the costs and benefits; ○ relevant outcomes from AEMO's work program (right); and ○ the OFA decision framework (see row 1). 	<ul style="list-style-type: none"> ● Estimate changes in modelled system benefits that result from staged implementation.

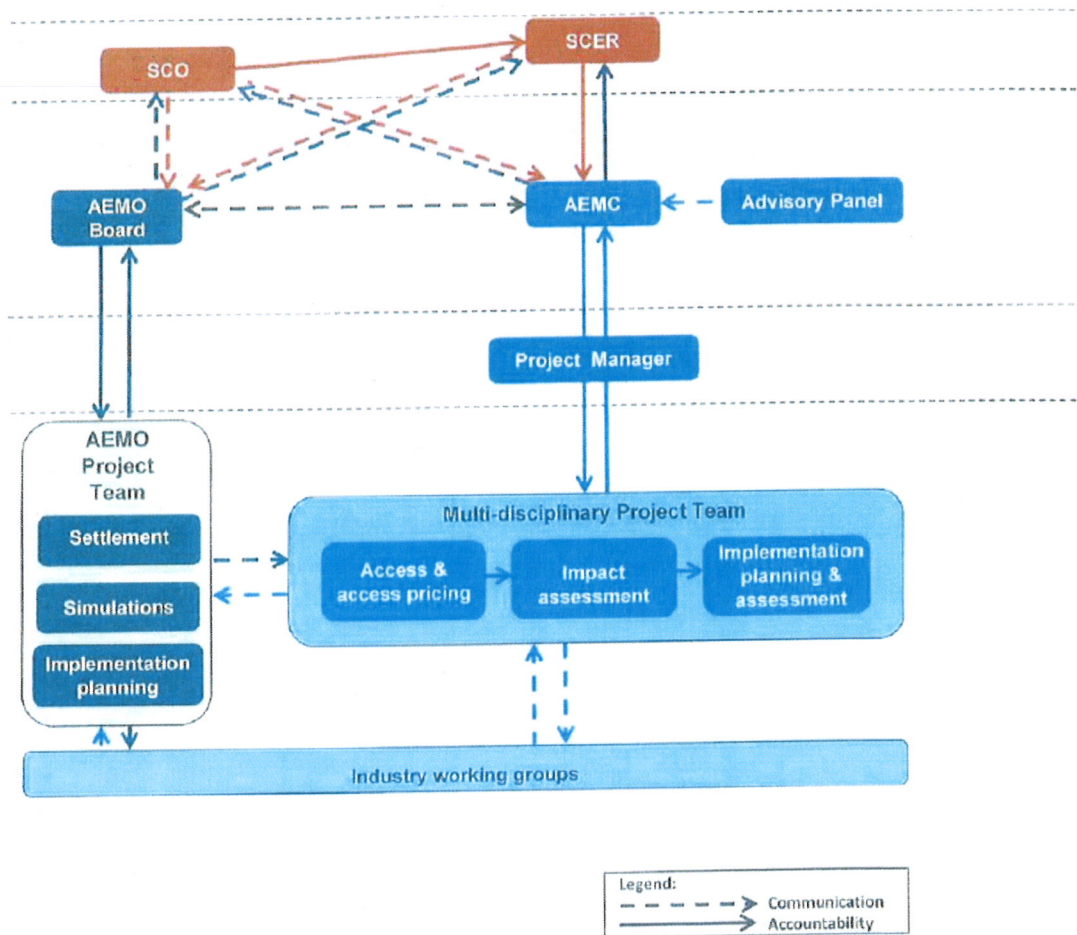
<ul style="list-style-type: none"> • Recommend an implementation plan detailing: <ul style="list-style-type: none"> ○ proposed tasks and deliverables; ○ proposed milestones and decision points; ○ estimated implementation costs; ○ proposed resourcing strategy; ○ governance structure (where any changes to the structure established for this design, testing and implementation planning phase are necessary); ○ communications and consultation strategy for engaging market bodies, officials, industry participants and other stakeholders; ○ identified risks and risk management plan; and ○ the proposed framework for making institutional, legislative and rule changes. 	
<ul style="list-style-type: none"> • Report to SCER recommending: <ul style="list-style-type: none"> ○ whether to implement OFA ○ the overall OFA design ○ the most efficient option for staging implementation ○ the implementation plan. 	<ul style="list-style-type: none"> • Recommend to SCER: <ul style="list-style-type: none"> ○ an implementation plan for access settlements, including a rule change proposal and specification of necessary systems changes, reflecting AEMC's recommendation on most efficient option for staging implementation.

Attachment 2 – Governance structure for the detailed design and testing of the OFA model and the development of an implementation plan

An AEMC-led multi-disciplinary project team, consisting of staff from the AEMC and secondees from transmission network service providers (TNSPs) and market participants, will carry out three work streams.

An AEMO project team will report to the AEMO Board.

Further detail on the roles of the different entities is provided below.



SCER or its delegates

- Provides the terms of reference for the work plan to the AEMC and AEMO, consistent with their respective roles in the market and governance arrangements.
- Decision maker on whether to proceed to implementation.

AEMC

- Confirms or modifies OFA design as a result of testing.
- Recommends to SCER an implementation plan.
- Provides regular updates to SCER officials.
- Directs and advises multi-disciplinary Project Team.
- Decision maker on design choices proposed by Project Team within SCER mandate.

Advisory Panel

- Provides review and advice to the AEMC.
- Made up of representatives from SCER officials, AEMO, AER, TNSPs, generators and retailers.

Project Manager

- Day-to-day management of project and budget.
- Reports regularly to AEMC.
- Decision maker on resource allocation, deliverables, timing and consistency of package as a whole.

Multi-disciplinary Project Team

- Detailed specification of:
 - access products
 - firm access standard and normal operating conditions
 - agreements between TNSPs and generators seeking access
 - access settlement method
 - access pricing method and relationship to reliability standards
 - transitional access allocation method
 - potential implementation staging
- Development of settlement and pricing models to allow simulations.
- Consultation on transitional access and implementation staging.
- Assessment of effects on contracting behaviour, risk allocation, commercial outcomes and inter-regional trade.
- Impact assessment to inform SCER decision whether to proceed to implementation.
- Reports to AEMC on tasks.
- Proposer of design choices on recommended and optional elements of access, firm access standard, access settlement and access pricing.

AEMO Board

- Recommends to SCER the functional specification for access settlement and associated changes to the settlements residue auction.
- Recommends to SCER an implementation plan for access settlement that would be agreed with the AEMC.
- Provides regular updates to SCER officials.
- Directs and advises AEMO Project Team.

AEMO Project Team

- Designs and develops a functional specification of the access settlements system consistent with design parameters provided by the AEMC.
- Review and identifies any changes to the existing SRA units that could be made to reflect their enhanced firmness under OFA.
- Tests market outcomes through access settlement simulations under different sets of assumptions about generator bidding behaviour and options for allocating access rights that will be agreed with the AEMC.
- Provides input into the implementation planning for the access settlements system.