

Australian Energy Markets Commission (AEMC)

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30 September 2021

Submission to AEMC EPR0087 Transmission Planning and Investment Review Consultation paper

The Australian Energy Council (AEC) welcomes the opportunity to make a submission to the AEMC EPR0087 Transmission Planning and Investment (TPI) Review Consultation paper (Consultation paper).

The AEC is the industry body representing 20 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the majority of the electricity in Australia, sell gas and electricity to over ten million homes and businesses, and are major investors in renewable energy generation.

Introduction

The planning regime of the monopoly transmission network are a self-evidently crucial part of the success of any competitive electricity market. This will always be challenging because it is a natural monopoly, expansion justifications occur in an environment of great uncertainty and are of a common rather than private nature and cost recovery is effectively guaranteed from parties uninvolved in the decisions. These circumstances make inefficient over or underinvestment, or early or late investment, highly probable and only the regulatory regime can protect against this.

The consultation paper recognises this great challenge and correctly focuses on the efficient use of customer funds as the transmission system participates in the power system's great transitions. The AEC makes some introductory remarks in relation to the review that it wishes the AEMC keep in mind:

- The AEC supports the Australian Energy Market Operator's (AEMO's) efforts in preparing an Integrated System Plan (ISP) which contemplates multiple feasible development paths for the NEM: some of which include major transmission development and transporting energy over distance, whilst others rely more on distributed supply. While each pathway is credible, the AEC broadly agrees with AEMO that large investments in major new transmission links appear cost effective at this time. It also notes this conclusion will remain subject to continuous change affected by many exogenous factors, for example batteries and other technological developments. Thus, even in this period of great change, new transmission should always be perceived as an economic *choice* rather than an imperative.
- The planning justification transparency arrangements are important to give confidence in the efficient use of customer funds. But there is an equally important rationale: every monopoly transmission investment will inevitably affect the profitability of competitive investments; and create winners and losers. If transmission investment occurs in an unpredictable manner with suspect justification, it will add risk and cost to the competitive parts of the industry¹.
- The creation of the ISP introduced some duplication in cost benefit analytical work between AEMO and other network planners. The AEC supports the Energy Security Board's (ESB's) "Actionable ISP" reforms which made considerable steps forward in this regard. The AEC supports the removal of unnecessary duplication, however:
 - Given the enormity of the proposed ISP transmission investments, it is entirely appropriate that considerable levels of effort are expended on testing the efficiency of investments before they become sunk costs.
 - Despite claims to the contrary, to the AEC's observation, the regulatory time constraints of the justification processes are not a material contributor to the time taken to develop transmission. Instead, they can largely run in parallel with good planning. The AEC considers the time involved in the economic regulatory processes are dwarfed by:

¹ For more discussion on this point, see <https://www.energycouncil.com.au/analysis/building-transmission-in-a-market/>

- The time to technically plan complex and expensive engineering in an environment of great uncertainty; and
- The times taken to gain environmental approval and community acceptance.

Notwithstanding the above, the AEC is supportive of the AEMC's proposed assessment framework for this Review.

Chapter 3: Issues in the regulatory framework and processes for planning major transmission projects

Implications of increased uncertainty for the ex-ante incentive-based regulatory framework

The AEC supports an ex-ante incentive based regulatory framework for monopoly assets, which is widely recognised as superior to cost-of-service regulation. However, the AEC also notes that ex-ante regulation works best in an environment of relatively stable capital expenditure. To that end, the arrangements already depart somewhat from the ex-ante regime through the contingent project framework, and it is not clear why this mechanism is unsuited to the ISP projects. Like all cost-of-service activities, the contingent project framework individual efficiency assessments may be at times frustrating. However, this is a necessary part of cost-of-service regulation, and the answer is not to increase the extent of cost-of-service regulation nor lower the assessment rigour.

While AER's recently released guidance for actionable ISP projects is helpful for TNSPs the AEC believes that the ex-ante incentive-based approach for these types of projects should form part of the AEMC's review.² The AEC believes contestability needs to be given serious consideration.

The AEC is supportive of the Review investigating approaches for streamlining economic assessments of ISP and non-ISP projects under the proviso that the current level of rigour is not compromised. Furthermore, 'streamlining' should only occur to refine situations where obvious duplication in processes is apparent and should never result in reducing the current levels of levels of rigor in the assessment process.

Benefits included in planning processes

The AEC is strongly supportive of market benefits remaining the primary metric for the economic assessment process. The purpose of the analysis of these projects is to determine how they will contribute to the functioning of the NEM and attempting to incorporate other 'benefits' would significantly reduce the integrity of the assessment process. Nor are such benefits consistent with the National Electricity Objective (NEO), which is to further the long-term interests of electricity consumers rather than, say, local employment. Furthermore, it would increase both the complexity and subjectivity of the results. For example, it is extremely difficult to capture the disbenefits of commensurately reduced economic activity in areas remote from the investment.

The AEC concurs with the commentary in the Consultation paper (page 27) and the work of the Productivity Commission in 2013.³ Furthermore, the AEC believes emissions reductions benefits can be captured in existing processes. For example, cost savings in meeting a legislated renewable energy target are each directly allowable as transmission justifications within the current framework. Claims that these fail to adequately capture environmental benefits appear to largely arise from the claimants' views that existing government environmental policies are insufficient. As such, the market benefits of the claimant's preferred policy are not capturable. The AEC considers transmission regulation is not the appropriate forum for a debate on government environmental policy ambition.

The AEC does not see the need for the Review to expend resources investigating incorporating other 'benefits' in the planning process.

Market versus consumer benefits test

The AEC is firmly of the view that only market benefits should be considered when assessing projects and that the Review should not expend further resources investigating alternative measures. The AEC has recently published an explanation as to why a consumer benefits test may actually reduce the level of transmission

² <https://www.aer.gov.au/system/files/AER%20-%20Final%20Guidance%20note%20-%20Regulation%20of%20actionable%20ISP%20projects%20-%20March%202021%20-%20FINAL%20FOR%20PUBLICATION%2812129318.1%29.pdf>

³ <https://www.pc.gov.au/inquiries/completed/electricity/report>

build.⁴ The existing test does permit the net market benefit arising from greater competition and notes this has been recently used in a major network augmentation.

Unequal treatment of non-network options under the RIT-T

While this has historically been a problem with respect to DNSPs (ie, the RIT-D), the enormous scale of planned transmission investment and rapid technological development indicate a need to further consider this issue with respect to the RIT-T. As there is an inherent conflict of interest that network service providers (NSPs) have when considering non-network alternatives. The AEC is supportive of the AEMC taking this forward as a priority issue for the review.

In considering this matter, the AEMC is encouraged to look into recent actions taken in South Australia to support system strength. Large investments in new synchronous condensers were taken rather than acquiring the service through agreements to operate existing non-network plant. Functioning markets require transparency.

As identified in the AEC's rule change proposal to reduce the RIT-D threshold, the RIT-D is not delivering as an effective competitive alternative to distribution businesses' capital expenditure plans. The AER's 2018 review of the RIT-D Guidelines demonstrated this. The AER identified only one successful non-network project from 10 competitive assessments and 16 RIT-D reviews since the RIT-D's introduction in 2013.⁵ Comparable incentives in the RIT-T will no doubt lead to comparable outcomes.

Chapter 4: Issues in the regulatory framework and process for transmission investment, financing and delivery

Balancing TNSP's exclusive right to build and own transmission projects

As noted in the Consultation paper, TNSPs have the "exclusive right to build and own transmission projects" but not the obligation.⁶ The AEC notes that the scale of current and planned discrete transmission projects may not align with the commercial interests or capacity of incumbent TNSPs. Projects should not be held up by unwilling TNSPs (that may have legitimate difficulties in obtaining the finance) or may use this monopoly position to bargain for more favourable regulatory treatment. This is a critical issue that needs to be resolved.

Should the delivery of transmission projects be made contestable? If not, why?

Subject to further consideration and analysis the AEC believes this is likely to be the most logical solution and should be a priority for the Review. The downside of contestability is that it tends to create planning and operating complexity in comparison to having a single monopoly owner. This is relatively minor however for the very large and discrete projects being proposed in the ISP. Furthermore, they almost always already involve developments that occur deep within at least two TNSP's territories.

Are there features of financing infrastructure projects used in other sectors that should be considered in the context of the efficient and timely delivery of major transmission projects?

The AEC would like to see the Review to consider alternatives to the current arrangements based on evidence from other infrastructure sectors. The AEC would like to see the Review take forward these issues as priority.

Chapter 5: Material change in network infrastructure project costs rule change request

The AEC notes efforts by network planners to improve early cost estimations and avoid a repetition of the large cost blowout that occurred in Project EnergyConnect that triggered this rule change. The networks' efforts are very welcome, but it is too early to be confident they have removed the rationale for the rule change. In the meantime, the proposed rule should provide a valuable incentive to estimate these costs more accurately up front. Ideally the networks' efforts should result in the question of material change never re-emerging. The AEC is of the view that the RIT-T does not need to be changed however it is worth reconsidering the quality of project cost estimates. For very large projects, class 3-4 Association for the Advancement of Cost Engineering (AACE) cost estimates may not be appropriate as the potential quantum of the errors is very large. The AEC

⁴ <https://www.energycouncil.com.au/analysis/customer-benefits-don-t-necessarily-benefit-the-customer/>

⁵ <https://www.aemc.gov.au/sites/default/files/2020-08/ERC0314%20Rule%20change%20request%20pending.pdf>

⁶ Consultation paper, p33.

would like the AEMC to consider whether more accurate (but also more expensive) cost estimates would better satisfy the NEO when considering large scale projects.

Who should decide whether the RIT-T must be reapplied?

The AEC is supportive of the AEMC further exploring which party determines whether the RIT should be reapplied. If this decision remains with the proponent, the AEC is supportive of the AER at least having the right to test the proponent's judgement.

Cost thresholds

The AEC does not have a view with respect to the proposed cost thresholds however the "decision rules" approach appears worthy of further investigation.⁷ The AEC is supportive of a requirement for updated project cost data be provided to AEMO to improve the accuracy of the ISP.

Conclusion

The AEC looks forward to the progress of this review at a time when investment in transmission infrastructure is being promoted as a primary solution to net zero emissions.

Any questions about our submission should be addressed to Peter Brook, by email to peter.brook@energycouncil.com.au by telephone on (03) 9205 3103.

Yours sincerely,



Peter Brook

Wholesale Policy Manager
Australian Energy Council

⁷ Consultation paper, p53.