

COAG Energy Council Secretariat
GPO Box 9839
Canberra ACT 2601

Submitted by email to energycouncil@environment.gov.au

20 October 2016

Review of the Regulatory Investment Test for Transmission

The Australian Energy Council (the Energy Council) welcomes the opportunity to make a submission to the COAG Energy Council Secretariat for the Review of the Regulatory Investment Test for Transmission (RIT-T).

The Energy Council is the industry body representing 21 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

The current framework appropriately balances regulated and non-regulated transmission asset investment and provides an open process to consider investments. The process gives transmission network service providers (TNSPs) and other market participants adequate opportunities to consider options to meet demand efficiently. Under the present RIT-T arrangements, any investment (paid for by consumers on a regulated basis) must be robust and provide a positive net welfare benefit in the majority of future scenarios considered.

However, Australia is undergoing significant energy innovation, greater energy efficiency and ongoing policy uncertainty which make the outlook for any energy investment risky and uncertain. It is timely to examine the framework for approving and providing a return on transmission infrastructure, to ensure it is flexible enough to cope with the uncertainty facing Australia's energy sector.

The system black event in South Australia in September 2016 should not be used to undermine the current framework. We support the principled approach outlined in the Consultation Paper which focuses on transparent cost benefit analysis and competitive neutrality as the best means of delivering value to consumers of transmission infrastructure. The Australian Energy Market Commission (AEMC) has the ability to require network service providers to apply the RIT-T to augmentation projects if they believe the current process is failing to deliver efficient outcomes. In 2016, the AEMC found that that transmission network companies are adequately considering the need for inter-regional transmission investment in their planning activities¹.

Accounting for risk in the assessment

Transmission projects are currently riskless investments, and competing projects in generation face risks that are factored into the pricing of generation projects. To ensure that investments are compared on a level basis, the RIT-T process needs to adequately factor in risk to the assessment of transmission to ensure the process does not become bias toward infrastructure. There is a tension in the current RIT-T process which stems from the partial substitution of transmission and generation where generation faces the market forces of competition while transmission is a regulated monopoly. To the extent that transmission substitutes for generation, the

expansion of transmission can reduce the feasibility of some generation. In the long run, this substitution can lead to closures of generation that may be more efficient or enhance power security when compared to network investment. Transmission investment should not be implemented to drive generation development, rather they must go hand in hand, driven by demand for energy.

A RIT-T assessment typically involves forecasts of new generation under a plausible future over 20 years, and the RIT-T generation scenarios should include higher weightings for committed supply developments, relative to speculative developments. While this may result in short periods where constraints occur, this is preferable to spending significant capital and committing long term expenditure on networks (and considerable cost to consumers) for which prospective generation ends up not going ahead. Consumers could ultimately pay more than necessary for transmission infrastructure that becomes underutilized because of policy change that changes generation development. Under the current renewable energy target uncertaintyⁱⁱ, there is a greater risk that projects will not go ahead or may be significantly altered before reaching a final investment decision. Weighting projects by likelihood to proceed may decrease the risk of incorrect estimation of the total amount and location of generation.

The role of interconnectors in balancing intermittent supply in South Australia has highlighted that both the RIT-T and the NTNDP may not take sufficient account of the security benefits and costs of interconnection. Whilst the test itself allows the inclusion of these benefits, the methodology for assessing the benefits has not to date included these benefits. This is partly because the methodology is probabilistic in nature, which may not account for significant, low probability, high cost deterministic events appropriately. These events may increase as significant structural adjustments change the nature of supply in the NEM. In some scenarios, interconnectors play an important role in transitioning the energy sector, to balance load and generation in complementary regions.

Greater oversight and transparency

The Australian Energy Regulator (AER) could play a larger role in providing scrutiny and oversight to the scenarios, assumptions and independence of modelling developed by proponents. To mitigate the risk of a conflict of interest amongst proponents developing the scenarios of future energy states, the AER could have a greater role in the review and consult publically on the assumptions and scenarios developed by proponents. The AER could seek advice which reviews the proponents' analysis. Currently, the AER does not review or consult on scenarios proposed, the input assumptions or the modelling undertaken by proponents. TNSPs engage third party advisors to conduct scenario development and modelling, but the AER does not seek its own independent advice to assess the merit of the assumptions underpinning scenarios. This proposal aims to increase transparency, and increase the rigor of modelling undertaken for project decisions.

Further work required

Under the existing technology and policy uncertainty, the challenge is to provide least cost, reliable energy to consumers while lowering emissions. The extent of the take up and type of intermittent generation, distributed generation, demand management and energy productivity add to the risk of long-term investments. As the energy sector transforms structurally, using a risk and time weighted approach to the costs and benefits modelled for the RIT-T may provide greater protection to consumers and mitigate the risk of inefficient outcomes. In the long term, it may be beneficial to reform transmission network payments to allow the investor to face some risk to their investment, creating incentives for efficiency and full consideration of all market and non-market options to supply energy.

The Energy Council has noted the concern by some governments that the RIT-T should be used for strategic investments – to facilitate renewables development and release potential sources of energy. This view of transmission changes the goal from demand driven investment to reduce congestion, to optimisation around a generation development plan. As demand for energy rises, supply rises to meet demand and existing network infrastructure can become congested under the higher flows of energy. A RIT-T should be the last step in a

broader process aimed at reducing congestion to maximise the efficiency of the supply of electricity to meet demand.

Summary

The Energy Council supports the need for a robust, independent, quantitative framework that provides protection to consumers who ultimately bear the risk and cost of transmission investment. The need to respond to changing market conditions should be carefully weighed against the long-term cost consumers may incur for incorrect decisions, and set the bar appropriately high relative to the risk to consumers.

Any questions about our submission should be addressed to Emma Richardson, Policy Adviser by email to emma.richardson@energycouncil.com.au or by telephone on (03) 9205 3103.

Yours sincerely,



Kieran Donoghue

General Manager, Policy & Research
Australian Energy Council

ⁱ AEMC, 2016, *Last resort planning power - 2016 review*, <http://aemc.gov.au/Markets-Reviews-Advice/Last-resort-planning-power-2016-review>

ⁱⁱ Victoria and Queensland both plan to implement state based renewable energy targets which could drive investment in each of the states, and significantly change the location and specification of previously estimated generation developments in the NEM.