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24 October 2018

Mr John Pierce AO
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

Re: Submission on Coordination of Generation and Transmission Investment (COGATI) review options paper

The Australian Energy Regulator (AER) welcomes the opportunity to provide our response to the Australian Energy Market Commission's (AEMC) COGATI review options paper.

We support the AEMC on this important piece of work, which AEMC staff have developed in consultation with staff from the AER and the Australian Energy Market Operator (AEMO). The options paper does an excellent job at raising questions that are both pertinent and important to the future development of the National Electricity Market (NEM).

We welcome the AEMC's work into considering a greater role for the integrated system plan (ISP), which offers an important NEM-wide perspective on investment. Giving effect to the ISP may require changes to planning and revenue setting processes. We welcome a transparent and informed discussion about what changes would promote timely decisions and outcomes in the long term interest of electricity consumers.

This submission mainly focusses the different options that the AEMC has discussed for making the ISP actionable. We have also included some views on renewable energy zones.

Overall comments

In considering future transmission planning and investment approval arrangements, we should recognise that consumers ultimately pay the bill. Consumers bear the risks of inefficient transmission investment under existing regulatory arrangements. Under the current open access arrangements, consumers (or load) pay for transmission charges, not

generators. Given the open access arrangements, any changes to the regulatory framework should maintain the existing framework's safeguards that minimise the risk that consumers will pay for the costs of recovering inefficient investment.

The AEMC's paper has identified a range of options for making the ISP an actionable plan. These options progressively provide a greater role for AEMO for transmission planning and investment decisions. In developing ISPs, AEMO will need to consult with not only Transmission Network Service Providers (TNSPs) but other stakeholders, and take information from these parties into account. Effective consultation with those affected by the ISP outcomes is a critical part of the ISP development process to promote the ISP's objective of identifying the likely optimal transmission investment pathway.

As part of our revenue determinations for TNSPs, including contingent project assessments, we are required to assess the economic efficiency of proposed transmission investments. Given the National Electricity Rules (NER) require TNSPs to conduct a cost benefit analysis of proposed investments through a regulatory investment test for transmission (RIT-T), we typically review the analysis in the RIT-T (where available) in assessing the economic efficiency of proposed expenditure.

Where AEMO, through the ISP, undertakes a RIT-T or another type of cost benefit assessment (that is, option 3 onwards), the AEMC has suggested the following AER approval role:

AER would need a regulatory framework by which it could approve the process of identifying options by AEMO, and its direction to the TNSP, to make sure that there is still a sufficient degree of regulatory oversight to protect consumers from inefficient network investment. Regulatory change would likely be required so that the AER has an approval role of the ISP and be able to test the investment against its usual efficiency objectives...

We agree that there should be a regulatory oversight role in assessing cost benefit assessments, whether undertaken by TNSPs or AEMO. We also consider it would promote a more efficient and streamlined approval process if our oversight role was integrated into the development of the ISP, rather than occurring afterwards. This would limit the need for any further efficiency assessments, thereby preventing us from retesting AEMO's economic analysis.

Elements of the current framework that should be included in any future framework

The AEMC has identified possible options for a new framework, including how the ISP and regulatory investment test for transmission (RIT-T) will interact. We support a further consideration of these arrangements, but note there are some desirable aspects of the present arrangements that should be maintained. Specifically, to promote the long term interest of electricity consumers in terms of minimising the risk in over-investment (where consumers pay more than necessary) or under-investment (consumers experience lower reliability and/or higher than necessary wholesale prices), transmission network planning and investment decisions should:

1. Undergo a rigorous cost-benefit analysis to ensure that these investments are in the long term interest of electricity consumers. This analysis should focus on identifying which credible investment/s have the highest net economic benefit to all those who produce, consume and transport electricity in the NEM. An analysis that achieves this effectively will have:
 - Focussed on maximising net benefits, which differs from minimising costs or simply testing whether an investment is net benefit positive (a net benefit positive

investment might not maximise net benefits if a competing investment offers higher net benefits).

- Focussed on costs and benefits for those who produce, consume and transport electricity in the NEM. This should prevent electricity consumers from paying to meet non-National Electricity Objectives (NEOs), such as non-NEO social and economic policies. While certain projects might have benefits outside the NEM (such as environmental or job creation benefits), non-NEO benefits are best considered by government decision makers in deciding whether to provide capital contributions towards certain projects. Under the current framework, government capital contributions reduce the costs to market participants, including electricity consumers. This effectively allows a wide range of benefits to be recognised under the RIT-T cost-benefit analysis.
 - Been applied at a sufficiently detailed level so alternatives to network investment were considered. The analysis would have explored different investment options without bias to energy source, technology, ownership or location, whether they are network or non-network options, and whether they are distribution-level or transmission-level investments.
 - Considered a sufficient number of internally-consistent scenarios and tested for key sensitivities to show whether the recommended option was robust to changes in assumptions.
 - Accounted for both the NEM-wide and localised impacts of investments, wherever this is material
2. Consider all credible investment options, including network and non-network options.
 3. Follow an effective consultation process where input assumptions and modelling methodologies are transparent so relevant stakeholders can understand what is driving investment outcomes.

Benefits and limitations of different ISP options

At a high-level, the five options that the AEMC discussed for making the ISP actionable have different potential strengths. For instance:

- Option 1 builds on the status quo by requiring TNSPs to consider investment needs that have been identified in the ISP. The advantage of this option is that TNSPs would undertake the cost-benefit analysis drawing on their local expertise. Moreover, because the timing for considering investment decisions would not be tied to the development of the ISP, this option might support more flexibility to respond to changes in market conditions.
- Option 2 extends upon option 1 by requiring TNSPs to conduct a RIT-T on investment needs and credible options that have been identified in the ISP. This option would likely have similar strengths to option 1 with the added advantage that the ISP would direct the TNSPs towards options that maximise net economic benefits across the NEM rather than just in their jurisdiction.
- Option 3 represents a more substantial shift from the status quo as the ISP would identify the 'best option', thereby taking a function that is currently performed via the RIT-T. This option should facilitate a NEM-wide perspective. Moreover, as an independent transmission planner, AEMO might be more technology- and ownership-

neutral than TNSPs when considering non-network options. Option 3 might also result in more efficient investment approval process as it would reduce the risk that mutually-exclusive RIT-Ts would be run at once. Connected to this, by having a number of investments assessed through the ISP rather than through individual RIT-Ts, option 3 might reduce duplicative processes for stakeholders when engaging in the consultation processes.

- Option 4 extends upon option 3 in that AEMO would direct the TNSP to implement the 'best option' it has identified in the ISP. Option 4 would likely have similar strengths to option 3. However, relative to option 3, this might better facilitate an efficient investment assessment and approval processes because the ISP would result in investment decisions being made, rather than only producing a recommended investment option.
- Option 5 extends upon option 4 as AEMO would also undertake the detailed costing and planning of the 'best option' and then direct the TNSP to implement the investment to detailed specifications (or run a competitive tender, similar to the current arrangements in Victoria). Option 5 would likely have similar strengths to option 4. However, any limitations of TNSPs being better placed than AEMO to consider locational information would be further exacerbated under this option.

Consultation process

Under any arrangement, effective consultation processes are important to promote stakeholder confidence and, where possible, acceptance of the outcomes of the process to facilitate improved decision making. We have published documents on effective consultation that the AEMC might want to refer to when developing any new consultation requirements.¹ We typically:

- publish an issues paper;
- hold a public forum;
- seek submissions;
- publish a draft report or decision;
- seek further submissions; and
- publish a final report or decision.

We have established 'Consumer Challenge Panel sub-panels' or 'Consumer Reference Groups' for important reviews. We have found these arrangements help consumers engage meaningfully in reviews. We support AEMO exploring how it might establish an equivalent panel or group when it develops the ISP.

As one moves from option 1 to option 5, the demands on AEMO increase with the amount of information it must consider and the amount of the consultation it must undertake. As such, while we would support future ISPs following a similar consultation process to that set out above, an increasingly extensive process might be required under options 3 to 5. Under these options, the ISP would be fulfilling the role traditionally undertaken by RIT-Ts in applying a detailed cost-benefit analysis to assess the efficiency of transmission investments. In developing a suitable consultation process for these options, the AEMC might also want to have regard to the RIT-T consultation process in the NER.

¹ For the AER's consultation framework, see AER, Revised Stakeholder Consultation Framework, September 2017. For the consultation framework the AER provides to network businesses, see AER, Consumer engagement guideline for network service providers, November 2013.

There is scope to streamline investment approval processes under the current arrangements. For example, we could have an ISP assessment, followed by a TNSP RIT-T, followed by disputes, followed by an AER assessment of revenue proposals. We welcome further discussion and are happy to provide input on streamlining options.

Renewable Energy Zones (REZs)

The options paper discussed the concept of REZs, focussing specifically on considering REZs that are not nationally strategic flow path projects identified in the ISP or other shared transmission projects that would be justifiable under the RIT-T or similar cost-benefit analysis.

Under option 4 in the REZ section of the options paper, a REZ based transmission investment is treated as a TNSP prescribed service and the assets are rolled into the TNSP's asset base regardless of whether generators connect to the REZ. The risk is asset stranding with upward pressure on transmission network charges and no benefit to consumers. Where an open access regime applies, consumers should not bear the risks associated with REZ based investment that is undertaken in anticipation of future generation need, unless this has been justified through a RIT-T or similar cost-benefit analysis under the ISP.

If you would like to discuss any aspects of our response, please contact Lisa Beckmann, (02) 6243 1379.

Yours sincerely

Paula W. Conboy

Chair

Australian Energy Regulator

Sent by email on: 24-10-2018