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Friday, 19 October 2018

Mr John Pierce  
Chairman  
Australian Energy Markets Commission  
PO Box A2449  
Sydney South NSW 1235

Dear Mr Pierce

#### **RE: EPR0052 – Co-ordination of Generation and Transmission Investment Review Options Paper**

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Australian Energy Market Commission's (the Commission) Co-ordination of Generation and Transmission Investment Review Options Paper (the Paper).

#### **About ERM Power**

ERM Power is an Australian energy company operating electricity sales, generation and energy solutions businesses. The Company has grown to become the second largest electricity provider to commercial businesses and industrials in Australia by load<sup>1</sup>, with operations in every state and the Australian Capital Territory. A growing range of energy solutions products and services are being delivered, including lighting and energy efficiency software and data analytics, to the Company's existing and new customer base. The Company operates 497 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland.  
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#### **General comments**

The Council of Australian Governments Energy Council (COAG EC) has requested that the Energy Security Board (ESB) report in December 2018 with regards to options to convert the Australian Energy Markets Operator's (AEMO's) Integrated System Plan (ISP) to an actionable strategic plan. This has coincided with the Commission's review of the Co-ordination of Generation and Transmission Investment. We support the Commission's decision to consider options to meet the task requested of the ESB to consider options to convert AEMO's ISP to an actionable plan as part of this review.

In considering options to convert the ISP to an actionable plan, we believe that the delivery of ongoing real benefits to consumers must be the centre of any decision. Changes to the current process for the approval of long-lived regulated transmission services may increase the likelihood that a network investment fails to deliver the purported benefits to consumers, the costs of which will be borne by consumers.

We support the discussion set out in the Paper to consider if the ISP in its current form is in fact "fit for purpose" to convert to an actionable plan and what changes would be required in the development of future ISPs to ensure that projects proposed in the ISP are correctly assessed prior to approval to construct as a regulated transmission service. In its current form we believe the ISP would not translate well to an actionable plan where the best interests of consumers are considered "first and foremost" in the decision.

<sup>1</sup> Based on ERM Power analysis of latest published financial information.



## Role of the Integrated System Plan

ERM Power believes the Integrated System Plan (ISP) represents the Australian Energy Markets Operator's (AEMO's) current view, in their National Planner's role, of some of the range of potential development options for generation and transmission which could eventuate in the future to facilitate the ongoing reliable supply of electricity to consumers in the National Electricity Market (NEM). As such, we believe the ISP provides a useful guide with regards to network investment options to be considered for more detailed and rigorous examination via a Regulated Investment Test (RIT) assessment by the relevant Network Service Providers (NSPs).

In developing any future ISP we believe that AEMO should be required to consider approved government policies as determined by the COAG Energy Council. In addition, AEMO could include policies currently under consideration and development in the ISP based on a direction by COAG to do so as a useful sensitivity outcome to inform debate on such policies. AEMO should not include their independent view of potential government policy directions in the ISP.

We also consider that the ISP should concentrate its efforts on providing guidance for potential projects that provide strategic benefits to the NEM as a whole, such as facilitating increased inter-regional transfer between the major regional load centres, rather than projects that provide intra-regional benefits only, as these would generally form part of individual NSP's Annual Planning Report function. We support the Commission's view in the Paper that criteria be established with regards to the assessment of what constitutes a "strategic NEM benefit".

In considering our view that the ISP should provide guidance only, we are mindful that it is also worth considering that in the past similar "current views" regarding the best options for development of the NEM have also been routinely published. Had these plans been actioned to investment, many would have resulted in unnecessary and significant costs for enduring periods being imposed on consumers. We believe the need for the ongoing provision of demonstrated net benefit to consumers under a wide range of credible scenarios should be the overarching consideration in determining what the best role is for the ISP in guiding transmission network investment.

Supporting our view, it should also be noted that in determining projects to be included in the 2018 ISP, AEMO considered only a limited range of scenarios based on a truncated consultation process. Given the ISP is currently published annually it is unclear if other than a brief consultation would be achievable in any future ISP's. In reality, there will be additional valid alternative scenarios not considered by AEMO during the ISP development process that will emerge during the consultation process required under a RIT-T assessment. We contend that the ISP provides only a guide as to possible outcomes in development of the transmission network not a definitive plan of how the network should be developed to deliver the optimum outcome for consumers.

Taking the above factors in consideration, ERM Power submits that any link by way of a rule change with regards to the ISP should only result in the options for investment as set out in the ISP proceeding to the next step with commencement of the formal RIT-T process to determine that the proposed project will deliver a net benefit to consumers. The ISP itself should not be considered a replacement for the RIT-T process.

## Options to strengthen the link between the ISP and investment decisions

The different options as presented in the Paper alter the balance of the allocation of risk to consumers in that an enduring investment based solely on AEMO's "current view" as set out in the ISP may ultimately fail to deliver a net benefit over the long term to consumers. ERM Power believes that in considering any rule changes to strengthen the link between the ISP and investment decisions that the option chosen must result in a clear demonstration that risks allocated to consumers are commensurate with consumer expectations and that this outcome is at the very centre of any option for a proposed rule change. We believe that this outcome is not clear for several of the options listed (notably Options 4 and 5) which seek to transfer greater levels of investment risk to consumers.



We are also concerned that the Paper contains a theme of the need for “greater speed” in investment decisions or that the investment process must be “faster”. In our view, a balance between speed and rigorous analysis must be considered. Simply getting through the investment decision process faster doesn’t mean that the right decisions will be made resulting in the delivery of benefits for the long-term interests of consumers.

In assessing a need for change from the current arrangements, we believe the Commission should in the first instance ask if a change is required. NSPs are required by the National Electricity Rules (the Rules) to consider the National Transmission Network Development Plan (NTNDP), (and therefore given that the ISP replaced the NTNDP in 2018, the ISP by default) in their APRs for the consideration of network development within their region and in consultation with other NSPs’s development between regions. NSPs work closely with AEMO and have significant input into the scenarios and projects chosen to be included in the ISP or NTNDP. Also, NSPs are sufficiently incentivised by the prospect of increased regulated returns to plan and construct regulated network investment and require little in the way of additional incentive to continue to do so. Should a NSP fail to consider any “strategic investment” the Rules contain a safety net provision by way of the Commission’s Last Resort Planner Powers (LRPP) to direct the relevant NSP(s) to commence a RIT-T assessment for the proposed project. We note that to date the Commission has not been required to exercise its LRPP and the annual LRPP assessment has not found any efficient investment that has not already been progressed by NSPs. Therefore it is unclear in our view that the existing arrangements have any fundamental shortcomings that must be improved.

In assessing the 5 options proposed by the Commission, ERM Power supports a combination of Options 1 and 2 as a balanced approach to strengthening the link between the ISP and a decision for transmission investment in the NEM. As set out in the Paper, AEMO would identify a potential need that would provide a strategic benefit to the NEM based on their “current view” and set out their views on possible credible options to address this potential future need. The relevant NSP(s) would then be obligated by the Rules to commence the RIT-T assessment within a nominal time period. This would ensure that strategic investment needs are prioritised with NSPs for RIT-T assessment. NSPs would be required to consider the credible options as set out in the ISP but would not be limited to assessing only those credible options contained in the ISP during the RIT-T assessment.

For clarity, ERM Power does not support the introduction of Options 4 or 5 as this replicates a world where a “central planner’s” view is imposed on the Market and transfers all risks for poor network investment decisions to consumers.

Should the Commission consider that Option 3 warrants further consideration, then we consider that any proposed rule change must ensure that as part of preparing and publishing the ISP, AEMO is required to perform the full RIT-T assessment for all proposed investments prior to formal approval by the Australian Energy Regulator (AER) that the investment may proceed to construction as a regulated transmission service. To assist with the process, formal AER involvement during the consultation phase of the ISP as well as a set timetable for genuine consultation with stakeholders must form part of any rule change package. We also consider that this change may necessitate a change to the requirement for AEMO to publish the NTNDP annually to publishing of the ISP every 2 years to ensure that sufficient time is available for consultation with the Market and to facilitate preparation and completion of any RIT-T assessments.

### **Regulatory Investment Test for Transmission**

ERM Power supports the ongoing use of the RIT-T assessment in the approvals process that transmission investment may be undertaken as a regulated transmission service where the cost of the investment is recovered from consumers. The RIT-T assessment process when correctly undertaken should ensure that only network augmentations that deliver a net benefit to consumers are approved. We are not aware of any valid reasoning that would support moving away from the RIT-T assessment process.



The Paper acknowledges that some stakeholders have raised concerns that the RIT-T does not adequately capture certain classes of benefits, we however note that the RIT-T Application Guidelines contain significant flexibility with regards to benefits which may be approved by the AER provided they relate to the benefits for those who consume, produce and transport electricity in the NEM. It may be that an application regarding these “supposed” benefits to the AER has not been made simply because they are not applicable for that RIT-T assessment or are unable to be quantified. We see no reasons to change the RIT-T with regards to benefits which may be included in the assessment.

The primary limitation we observe in the current RIT-T assessment process is related to the poor governance associated with the proponent undertaking the RIT-T modelling. ERM Power submits that from a good governance perspective the actual modelling should be performed by an independent modelling panel regulated and maintained by the AER with costs of modelling paid for by the proponent(s). Modelling outcomes would be released by the AER to the proponent(s) and the Market at the same time. This would ensure complete independence and transparency in the modelling process which is currently fully controlled by the proponent(s) and opaque to other parties.

In considering this change we believe that the Commission should consider that during the Heywood interconnector upgrade assessment and approval process, independent modelling of the benefits of the preferred option replicating the input assumptions published by the proponent(s) was undertaken by Frontier Economics and supplied to the AER. This independent modelling concluded that the upgrade would not deliver the benefits to consumers claimed by the proponents. To date, that has been the case with flows limited below 75% of those claimed in the proponent's assessment of the upgrade outcomes. Despite this, consumers continue to pay for the full costs of the upgrade works.

The other area where we believe the RIT-T may require improved clarification is with regards to benefits claimed for a project which is contingent on other future projects passing a RIT-T assessment and being constructed. The benefits should be assessed based on both the benefits of the project on a standalone basis and also the benefits that would be derived should the other future projects eventuate. This change will move to remove the risk that projects of negative net benefit to consumers will be approved after being aggregated and cross-subsidised by projects with more demonstrable benefits. Where points of intra-regional congestion exists that will impact the ability of a project to deliver benefits this intra-regional congestion must be included in the modelling and not simply assumed these will be built out at a later date. Where the modelling assumes that the intra-regional congestion is to be removed, the costs for the project in the RIT-T assessment must include the full costs for removing these points of intra-regional congestion. By way of example, the benefits claimed under the Eyre Peninsula Upgrade for the proponent's preferred option assume that network congestion between Cultana and Davenport and Davenport to either the Regional Reference Node (RRN) or Robertstown will be removed in the future. Without this, actual benefits to consumers will fall well short of those claimed in the RIT-T assessment.

In assessing the length of time in undertaking the RIT-T assessment and the overall time to plan, approve and construct a new transmission investment, the actual timeframe allocated to consultation with interested parties is relatively short; the majority of time is consumed by processes to be undertaken by the NSP. If it is felt that the overall investment process needs to be “faster” we contend that tasks outside the RIT-T consultation windows be examined first, rather than considering a change to “speed up” the RIT-T.

The Paper also raises concerns that a “spurious” dispute could be lodged to delay the RIT-T approval process to gain a commercial advantage. To date we are not aware that any “spurious” disputes have been lodged. The ability to lodge a dispute if required is important to ensure that consumers' and participants' input are properly considered by the proponent(s) during the assessment process. Removing or modifying the ability to lodge a dispute regarding the RIT-T assessment would potentially reduce the level and authenticity of consultation undertaken by the proponent(s).



## Renewable Energy Zones

ERM Power supports the introduction of Renewable Energy Zones (REZs) into a transmission investment assessment where it is clearly demonstrated that by doing so the net benefit to consumers is increased. We believe the current regulatory framework allows for a REZ to be considered by a NSP seeking to invest in either regulated or non-regulated network investment, a generator or group of generators seeking to connect to the network or a government jurisdiction wishing to directly fund increased network capacity within or between regions. The primary question we believe is with regards to how a REZ investment is funded and how investment risks are allocated between consumers and other parties who also benefit from the REZ.

Notwithstanding our support for the introduction of REZs, consumers should only pay for the least cost option to deliver the demonstrated need. Whilst consumers could be expected to pay for network augmentation that increases flows within and between regions, consumers should only pay for the most direct route unless the assessment of the different credible options under the RIT-T assessment demonstrates increased net benefits for an alternative route. Where the NSP chooses to augment the network via a longer circuitous route to facilitate additional REZs, to achieve decreased network connection costs for generators, consumers should only pay the additional costs of the circuitous route where this delivers a demonstrated net benefit increase to consumers. A more direct route with dedicated connection asset branches may deliver the same level of benefits to consumers at lower overall market costs. We believe these are alternatives that must be assessed during the RIT-T assessment.

On Option 1 for the introduction of REZs to the NEM, we agree with the Commission that an increase in the level and accuracy of information currently provided to the market to facilitate this option is required and we support this additional information provision. We also remain convinced that AEMO in its National Planner role has an increased role to play in co-ordinating the supply of timely and accurate information regarding network capability to the Market and advising interested parties of alternative network connection locations and costs.

With regards to Option 3, we note that the Rules already allow for speculative investment by an NSP in transmission. The NSP would be free to recoup their investment by either connecting generators as a non-regulated asset or undertaking a RIT-T assessment to convert the transmission assets at a later date to a regulated transmission service.

We support the Commission's view that additional assessment of ENGIE's proposal to the Discussion Paper whereby an NSP would issue transmission bonds of sufficient value to underwrite a transmission infrastructure project based on the estimated costs may be warranted. In that scenario the speculative nature of the investment could be minimised to the NSP and allow generators to connect to the network at lowest costs. The Transmission Bond would be refundable in whole or part to the bond holder(s) following completion and AER approval of a RIT-T assessment to convert the network assets to a regulated transmission service. We do not support the automatic conversion of the network asset on completion to a regulated transmission service without completion and approval of a RIT-T assessment as this would promote circumvention of the RIT-T process.

We also believe it should be clear that generators co-ordinating via Option 3 to facilitate construction of a shared connection asset, or REZ connection, are only facilitating the construction of the most efficient connection asset to the shared network, not firm access to the regional reference node.

We support the Commission's view that Option 4 should not be considered further as part of this review.

## Congestion and access

Currently it is not clear to ERM Power that the Commission's conclusion that access and congestion management issues are likely to need to be addressed in the near term, once the role of the ISP has been addressed will promote the best outcome for the NEM and consumers.



Congestion could occur without impacting secure operation of the power system or reliability and overall cost of supply to consumers. It is only where a net benefit to consumers for changing the current framework for removing or managing congestion is demonstrated that changes to the current transmission access and connection framework should be considered.

As indicated above, and in our submission to the Discussion Paper, ERM Power maintains that the supply of accurate congestion data in the form of uncongested headroom and other related data at different connection locations across the network is the first step that must be achieved prior to the consideration of any changes to the current framework. We believe it is the lack of this accurate information to the Market that is the primary cause of poor locational decisions by prospective generation.

### Treatment of Electricity Storage

We support the Commission's framing and definition of the issue and the Commission's initial views of whether or not storage should pay transmission use of system (TUOS) charges. We believe that storage will have a significant role to play going forward for both ongoing secure operation of the power system and reliable supply to consumers. Where possible the rules should set clear outcomes to ensure any "barriers to entry" for investment in storage are minimised as much as possible. To this end, we believe the final report should recommend that the AER undertake consultation on their current Transmission Pricing Methodology Guideline to ensure clarity for both NSPs and storage project proponents with regards to the calculation of TUOS charges, if deemed applicable, for all storage projects. This will allow prospective proponents of storage to assess their investment decisions based on a clearly defined structure without the need for repeated interaction with a NSP or the AER.

### Conclusion

In considering the questions posed in the Paper, we believe that changes to the current frameworks for approval of regulated network investment is only justified where there is clear demonstration that the existing frameworks are deficient, an increase in net benefits to consumers will occur and allocation of risks that a proposed network investment will fail to deliver its purported benefits are allocated to those best placed to manage these risks.

We are concerned that a number of the options proposed in the Paper to move the ISP from a central planner's view of the future NEM to an actionable plan, results in increased risk being transferred to consumers who we believe would not be best placed to manage this risk. Currently, to ensure consumers are not unduly exposed to the risk that a regulated network investment fails to deliver a net benefit to consumers, the Rules require that the network project proponent(s) complete a regulated investment test to ensure that under a range of probable future scenarios consumers continue to receive a net benefit. We fully support the ongoing use of the RIT-T assessment and AER approval process as the final determinant of investment in regulated transmission network infrastructure.

We do not believe any significant change in the network investment framework is required to move network investment flagged in the ISP which has the potential to deliver a net benefit to consumers through formal consideration via the RIT-T assessment and approval process. In our view NSPs are sufficiently incentivised through the prospect of increased regulatory return for an enduring period to progress the assessment in a timely manner. If the Commission believes a stronger link between the ISP and NSP action is required, then a small change to the Rules to require the NSP(s) to commence the RIT-T assessment within a nominated time period is in our view all that may be required.

Whilst we fully support the ongoing use of the RIT-T assessment process, we believe that the current process could be improved from a governance perspective to ensure that the actual modelling of benefits is performed independent from the proponent. Alternatively, the AER could be required to have independent modelling of the preferred option undertaken whenever the total costs of the project exceed a \$100M threshold. Either would provide increased confidence to consumers in the form of independent verification that the benefits claimed by the proponents for the project have a firm prospect of delivery.



Please contact me if you would like to discuss this submission further.

Yours sincerely,

[signed]

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