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Mr John Pierce AO

Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Lodged Via AEMC Website

Dear Mr Pierce,

COORDINATION OF GENERATION AND TRANSMISSION INVESTMENT – ACCESS REFORM (EPR0073): PROPOSED ACCESS MODEL AND RENEWABLE ENERGY ZONES DISCUSSION PAPERS

Palisade Investment Partners (**Palisade**) welcomes the opportunity to make this submission on the Coordination of Generation and Transmission Investment (**CoGATI**) Proposed Access Model Discussion Paper and Renewable Energy Zones (**REZ**) Discussion Paper (together, **Discussion Papers**) released by the Australian Energy Market Commission (**AEMC**).

Palisade is an Australian infrastructure investor with a portfolio that currently includes investments in four renewable energy projects with a combined capacity of over 450MW in the National Electricity Market (**NEM**). In addition, Palisade is invested in the broader Australian energy market through its investment in two east-coast natural gas transmission pipelines, and a peaking power station located in Western Australia. Palisade invests in these projects on behalf of its investors which are primarily Australian superannuation funds.

Palisade is also a member of the Clean Energy Investor Group (**CEIG**) which represents a group of 20 significant renewable energy developers and investors, with collectively over 6,300MW of generation investment in the NEM and a future development pipeline in excess of 10,100MW. Palisade supports the submission made by John Laing on behalf of the CEIG on the Discussion Papers.

Need to address investment risk in an orderly manner

Palisade strongly believes that creating a robust investment environment that will enable the efficient investment in new generation, storage and transmission capacity is imperative to achieving the long-term customer outcomes as set out in the National Electricity Objective (**NEO**). To create this investment environment, it is important that the regulatory reform process is undertaken in a coordinated manner that avoids unnecessary complexity and volatility and the associated risk premiums that result in a higher cost of capital for projects.

From an investor perspective, escalating uncertainty has already, and will likely continue to, lead to a material reduction in existing asset values and therefore require an additional risk premium to be applied to any new investments. This additional risk premium could be applied by both equity and debt investors. This is expected to increase the cost of capital associated with the future investment required to fund the 54GW of new capacity needed in the NEM by 2040, which will ultimately be passed on to customers through higher wholesale prices.

Critical issues with AEMC's proposed CoGATI framework and access model

Exclusion of transmission planning

Palisade notes that the scope of the CoGATI Review has been amended to exclude transmission planning and operation. The issues the CoGATI Review is intended to address are a function of the physical network and the interaction between generation and transmission, and the investment in each of them. The removal of transmission planning from the revised scope significantly limits the ability of the review to achieve its objectives.

In its current form, Palisade does not believe that the proposed access model delivers any real tangible link, or will deliver better coordination, between generation and transmission investment. Instead, it is a very complex access model that will not assist with the pressing need for increased transmission capacity.

The proposed access model increases complexity and investment risk

The introduction of Locational Marginal Pricing (**LMP**) and Financial Transmission Rights (**FTRs**) increases the complexity of the market and consequently the investment risk associated with investment in new generation and storage projects. The AEMC present FTRs as a risk management tool however Palisade believes the introduction of a complex, short-term, non-firm instrument significantly increases the cost and complexity of participating in the NEM without providing any additional long-term investor certainty.

The introduction of LMP and FTRs is expected to significantly complicate the way generators currently manage pricing risk in the market, through power purchase agreements (**PPAs**), and potentially de-value or remove the fixed price nature of these agreements.

Extending the tenor of the FTRs is not expected to address the issue as it would be impossible to effectively price a long-term FTR given the uncertainty surrounding the timing and location of the forecast 54GW of new capacity and associated transmission upgrades.

The complexity of pricing FTRs and participating in the FTR auction process places an additional burden on developers and owners of generation projects which is expected to disproportionately impact smaller market participants and create an additional barrier to entry for new competitors seeking to enter the market and increase ongoing costs.

Contrary to the AEMCs assertion that the "arrangements should improve investment certainty for generators and storage and may reduce their cost of capital in the longer term"[1], based on the current proposed access model <u>Palisade would apply an increased cost of capital to its investments to reflect the increased uncertainty</u>. Palisade would also expect adverse impacts on the availability and cost of debt for projects, further increasing the weighted average cost of capital. Increased costs of capital are ultimately passed on to customers through higher wholesale electricity prices.

Timetable and Transition Arrangements

The proposed July 2022 timetable for the implementation of the LMP and FTRs does not reflect the current status of the proposal including the level of detail, analysis and consultation, the complexity of the proposed reform and the transitional arrangements that will be required. Proceeding with the proposed reform on this timetable is going to further increase investment uncertainty and put at risk future investment in new generation.

[1] Discussion Paper - CoGATI access reform 14 October 2019, Page v

Among other things the AEMC do not appear to have sufficiently considered how LMP and the use of volume weighted average price will impact existing PPAs (and generator behaviour such as 'race to the floor bidding' as a result of these PPAs), the changes required to AEMO's systems and implementation of grandfathering arrangements.

The lack of detail provided is particularly concerning, with Palisade having spoken to a number of consultants who have either formed differing views or been unable to form a firm view (based on the Discussion Papers and interaction with the AEMC) on how, when and where 'local prices' will be determined, a fairly fundamental concept within the access model.

Given the structural changes proposed, Palisade does not agree with the AEMC's conclusion that the proposed access reforms represent a no regrets step that is suitable for any post-2025 design of the market that may arise as a result of the Energy Security Board (**ESB**) post 2025 Market Design Review. Instead it represents the real possibility of two radical market reforms within a five-year period.

Further work is required to define the detail of the proposed reform including transition arrangements and interaction with other reform processes and rule changes before setting the implementation timetable.

Coordinating and prioritising reform in order to address investment risk

Given the interaction of a number of the market review and rule change processes and the scale of reform being contemplated it is important to coordinate and prioritise these activities. Palisade does not believe that the proposed access model addresses the objectives of the CoGATI Review and is better considered in conjunction with, and as part of, the ESB post 2025 Market Design Review.

Palisade, through the CEIG, is committed to working with the AEMC and other key stakeholders on the important reform agenda. Palisade and the CEIG believe the priority should be implementing Marginal Loss Factor (**MLF**) reform, followed by putting in place a framework that will deliver the transmission network required to facilitate the energy transition, including Renewable Energy Zones (**REZ**). REZ reforms should be consolidated with the actioning of the ISP given the inextricable link between areas of high renewable energy penetration and transmission planning and operation. Wholesale market reform should be considered more holistically as part of the broader reform packages rather than being developed independently.

As stated in the CEIG's July 2019 submission to the Transmission Loss Factor Rule Change Consultation[2], which Palisade supports, an interim change to Average Loss Factors (**ALF**) was recommended whilst the completion of CoGATI's mandates (first transmission planning, then access pricing, then financial hedging) and the ESB post 2025 review are completed. The change to ALF now would improve certainty for investors, keep energy prices lower for consumers and would be a "no regrets" decision between now and when an industry agreed framework for making the ISP and improved coordination between generation and transmission is a reality.

Under the LMP proposal, MLFs will be replaced with loss factors determined through dispatch, which the AEMC acknowledge could potentially increase the volatility of loss factors[3]. As noted in the CEIG submission to the AEMC's transmission loss factor consultation the recent volatility of MLFs is already having a material impact on investment with any increase in volatility expected to be detrimental to generation investment.

The AEMC cite the introduction of FTRs as a mechanism to hedge the risk associated with loss factor volatility. The non-firm 4 year FTR product proposed by the AEMC fails to hedge the

[2] https://www.aemc.gov.au/sites/default/files/2019-07/Rule%20Change%20SubmissionERC0251%20-%20John%20Laing%20-%2020190718.PDF
[3] Discussion Paper - CoGATI access reform 14 October 2019, Page 22

long-term uncertainty facing investors considering 30 year investment decisions while at the same time increases the cost and complexity of future investments. It also does not address the current problem whereby a new generator can easily connect directly next to an existing generator, thus reducing the existing generator's level of access and impacting their loss factor. This problem will still exist under the AEMC's proposed access model and will simply drive up the cost of FTRs and increase the difficulty in forecasting the impact of a new generator and the underlying value of FTRs, with no reduction in congestion or loss factors.

In short, the proposed LPM and FTR frameworks do not address transmission loss factor risk and will potentially increase loss factors and market pricing volatility. This is expected to result in an increase in the cost of capital for both existing and new generation investment, and ultimately lead to higher customer electricity prices.

Achievement of the National Electricity Objective ("NEO")

The AEMC have proposed the introduction of LMP as the recommended access model without assessing the costs and benefits of the reform relative to the current framework or alternative access models. It is not clear from the information provided by the AEMC to date that the proposed reform delivers the long-term customer benefits required to satisfy the NEO.

The approach taken to date by the AEMC is in contrast to the AEMO ISP which is backed by modelling and engineering analysis. Palisade believes a more detailed analysis of the costs and benefits of LMP and FTRs versus both the current framework and alternative models is required before selecting a preferred access model that represents a structural change to the wholesale electricity market.

As detailed above, Palisade believes that in its current form, the proposed access model will result in increased uncertainty and investment risk, leading to a higher cost of capital demanded by generators and therefore higher wholesale electricity prices. Accordingly, Palisade believes that the proposed access model is not consistent with the NEO.

Recommended Approach

To create an investment environment that will enable an efficient cost of capital and ultimately the desired long-term customer outcomes, Palisade supports the recommendations of the CEIG that the AEMC prioritise following activities:

1. **Implement the Average Loss Factor rule change proposal**

   The proposed change from MLF to ALF provides a no-regrets solution that will reduce the level of loss factor volatility, improve investment certainty and restore investor confidence – all of which will keep consumer prices lower than in the current situation, while the broader reform program progresses.

2. **Actioning the Integrated System Plan including the Renewable Energy Zone framework**

   The design, development and delivery of the new transmission network associated with the ISP needs to draw on the best of the coordinated planning methods that delivered our current network, as well as the market-based mechanisms that delivered operational efficiency to that network after completion. Whether it is sending signals for investment in the REZs or investment in augmentation of the existing network there is broad industry agreement and learnt experience from around the world that dynamic pricing and transmission do not send the coordinated or certain enough signals required for delivering these monopoly regulated assets.

3. **Broader Market Reform Program (including potential wholesale market reform)**

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The ESB has commenced the process of the post 2025 Market Design Review which has been on the reform agenda for some time. The post 2025 Market Design Review will be critical to defining the future of the NEM as we progress through the energy transition and will hopefully establish a clear objective that market participants and stakeholders can work together towards. Palisade believes this is the logical forum for any review of the structure of the wholesale electricity market (including the CoGATI access model).

Palisade, in conjunction with the Clean Energy Investor Group, is committed to collaborating with industry, the ESB and the AEMC to deliver best in class solutions for the CoGATI reform.

Please do not hesitate to contact me should you have any queries.

Yours sincerely,

Roger Lloyd

Managing Director and CEO

Palisade Investment Partners Limited