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18 August 2022

Ms Anna Collyer
Chair
Australian Energy Market Commission (AEMC)

Via electronic lodgement

Dear Ms Collyer

Transmission Planning and Investment Review Contestability Options Paper (EPR0087)

AusNet welcomes the opportunity to make this submission in response to the AEMC's Transmission Planning and Investment Review (TPIR) Contestability Options Paper (the Options Paper).

AusNet is the largest diversified energy network business in Victoria with over $11 billion of regulated and contracted assets. It owns and operates three core regulated networks: electricity distribution, gas distribution and the state-wide electricity transmission network, as well as a significant portfolio of contracted energy infrastructure. It also owns and operates energy and technical services businesses (which trade under the name "Mondo").

The AEMC's Options Paper arrives at a time where contestability arrangements are being refreshed in Victoria and adopted in NSW. The actions of these jurisdictions highlight the limitations of existing frameworks for planning and delivering transmission infrastructure and a desire to have the full suite of tools available to procure major transmission projects available during the energy transition.

AusNet welcomes the AEMC exploring the net-benefits of introducing contestability for major transmission projects as an alternative to the existing regulatory framework.

Our attached submission is guided by our practical experience competing to build, own, operate and maintain large transmission projects in Victoria and interstate. It is also informed by our experience competitively tendering for IUSA and connection assets outside of Victoria.

This experience places AusNet in a strong position to articulate why the AEMC should explore the net-benefits of introducing contestability for major transmission projects as a no regrets action. In addition to the cost savings identified in the KPMG report, the increasing scale and urgency of transmission investment warrants consideration of the diversity benefits of sharing delivery risk amongst a broader pool of network service providers. Finally, many of the disadvantages asserted against introducing contestability (e.g. time and transaction costs) are more relevant for small to medium sized projects rather than major transmission projects.

We have also provided our perspective on the model features most important to maximising the net-benefits of contestability. This includes opportunities to create a level-playing field between all tenderers, and the importance of allocating planner-procurer responsibilities to entity best able to execute those functions and incentivised to do so. Our preference is that any preferred contestability model adopts a Jurisdictional Planning Body as its responsible planner-procurer, as a body with the legitimacy to arbitrate appropriate allocation of costs and risks between energy consumers and the proponent, and the financial clout and incentives to address and mitigate planning or delivery risks too great for consumers or proponents to bear.

AusNet agrees that not all major projects are suitable to competitive delivery and suggests the AEMC apply a prescriptive approach to give certainty to tenderers about the pipeline of major projects. Provided the AEMC agrees with this approach, we suggest the AEMC carefully consider the definition of the monetary threshold and separability. Clarifying both would help maximise net-benefits to consumers and may remove the need for a second checkpoint to consider whether it is appropriate to proceed with a competitive procurement process for projects that are suitable for contestable delivery.

Strawperson model 1 is inconsistent with many of the abovementioned model features and is therefore not suitable for further consideration. While in theory strawperson model 4 is most able to leverage the benefits of contestability, in practice, it has high cost and complexity of reform to execute.

We note that some of the points made in this submission are covered in detail within our response to the TPIR Issues Paper. We encourage you to review both submissions together.

If you have any questions regarding this submission, please contact Jason Jina, Energy Policy Lead by email at jason.jina@ausnetservices.com.au.

We look forward to opportunities to continue to provide input into the AEMC's TPIR and broader contestability work program.

Sincerely,

Jack San
Manager, Energy Policy
AusNet

AusNet

AusNet submission in response to the Transmission Planning and Investment Review Contestability Options Paper

Australian Energy Market Commission (AEMC)

Thursday, 18 August 2022

1. Introduction

AusNet Services Ltd (AusNet) is pleased to provide our response to the AEMC's Transmission Planning and Investment Review (TPIR) Contestability Options Paper (the Options Paper).

Our response:

- Welcomes the AEMC decision to explore the net-benefits of contestability as an alternative to the existing regulatory framework and provides key reasons why this is merited (Section 2)
- Provides our perspective on the model features most important to maximising the net-benefits of contestability (Section 3)

Please note while not commented on below, AusNet supports the AEMC's two-part approach to its contestability workstream.

2. AusNet welcomes the AEMC exploring the net-benefits of contestability

AusNet welcomes the AEMC's decision to expand the scope of its work to fully consider the net-benefits of introducing contestability for major transmission projects as an alternative to the existing regulatory framework. Key reasons are explored below.

Jurisdictions should have access to full suite of tools to procure major transmission projects available during the energy transition

Major changes in the generation mix and increased demand for electricity have placed our transmission system under stress and highlighted limitations within existing frameworks for planning and delivering transmission infrastructure. These include issues with undertaking anticipatory investment, coordinating generation and transmission development to minimise investment risk and incorporating the views of communities hosting infrastructure into key project decisions.

Policy makers and industry are working hard to resolve these issues through state and federal policy initiatives, and national policy reform. As part of this, there is an increasing recognition that the increasing scale and urgency of transmission investment required in Australia merits introducing contestability to:

- Provide diversification benefits – by sharing delivery risk for the volume of large projects needed amongst a broader pool of network service providers (tenderers)
- Is a no-regrets action to validate whether the existing regulatory framework is delivering value for money for consumers in terms of total cost, cost certainty, timely delivery and risk allocation.

In this context, AusNet supports the AEMC exploring whether to introduce contestability within the national arrangements to provide jurisdictions and their consumers with the full suite of tools to procure major transmission projects, even if provided on an opt-in basis.

We also support the assessment of the net-benefit of introducing contestability against the counterfactual as described in the Options Paper (i.e. current arrangements outside Victoria) and agree adjustments will need to be made to reflect any future TPIR recommendations.

Many of the disadvantages asserted against introducing contestability are more relevant to small-medium sized projects rather than major transmission projects

Consistent with our submission to the TPIR Issues Paper, AusNet sees the TPIR as an opportunity to make a balanced assessment of where contestable models of transmission provision could provide benefit to energy users.

Part of this recognises some disadvantages asserted against introducing contestability are more relevant to small-medium sized projects than for 'major transmission projects' as defined in the Options Paper. These arguments include:

- **Time and transaction costs of undertaking a competitive tender process** – An open tender and evaluation process adds a minimum of six months to tender the service compared to the regulated project. However, consistent with the AEMC's supporting KPMG report, AusNet considers that contestability can significantly reduce the cost of delivering major transmission projects and the risk allocation borne by consumers. In other words, major transmission projects are better suited to benefit from contestability, as opportunity for cost savings from small to medium sized projects is unlikely to outweigh tender costs.
- **Difficulty in maintaining clear accountability for overall system security, reliability and safety under a contestable model** – AEMO as the system operator is responsible for power system security. In this role, AEMO coordinates

multiple jurisdictions and coordinates (or delegates) various power system security responsibilities with TNSPs within those jurisdictions. This demonstrates that the current system architecture is sufficiently flexible to accommodate multiple parties building, owning and operating transmission infrastructure. This is particularly true for major transmission projects such as interconnectors, which are more likely to be discrete and separable. Safety will continue to be underpinned by jurisdictional obligations including transmission licence conditions that apply to all TNSPs.

- **The greatest cost savings from allowing competition arise during the construction phase which Primary TNSP's use economies of scale to contestably source under the regulatory framework** – AusNet agrees this is likely to be the case for smaller projects, where procurement is the greater driver of cost savings. However, for larger projects there is wider opportunity to improve solution design and optimise delivery risks to produce cost savings over and above competitive procurement savings.

  This is because by adjusting equipment selection and through innovation in layout, operation and delivery models a non-incumbent tenderer can significantly reduce the total cost of equipment (substations, lines, towers), construction, and/or optimise the route to reduce land or easement acquisition compared to a 'standard' solution that might be provided by an incumbent.

  Further, a well-designed contestable model can introduce the right contractual incentives and processes to carefully manage delivery risks. For example, both the preferred proponent and the Primary TNSP (should they be different parties) are bound to a performance incentives scheme that encourages them to reach project completion and commissioning on or before the agreed date. The performance incentives scheme can also encourage the delivery of other priorities, for example wider economic benefits through social procurement requirements.

  Over time, contestable models can encourage alternative ways to deliver these projects and outperformance (i.e. innovation and flexibility within the project delivery methodology that mitigates delivery risks). By contrast, the existing regulatory framework offers fewer incentives to reach project competition and is relatively inflexible with the incentives set in the rules frameworks.

Other common concerns are around:

- **Transparency of information available about project costs when agreed through a contestable process compared to regulatory framework** – While these apply to all major transmission projects, such issues can be managed by placing additional governance obligations on the planner-procurer who is accountable for negotiating the terms of service. For example, an obligation to confirm whether the costs are within their original envelope agreed as part of the regulatory approvals process.
- **Continuity of engagement with landholders and the broader community**. As in all transmission planning processes (contestable or regulated), the trust communities hold in the process is likely to be impacted where they have not had a meaningful opportunity to provide input into key decisions. In a contestable model, community acceptance risks can be managed by:
  - Introducing a single handover point between the planner-procurer and successful proponent;
  - Ensuring the planner-procurer has a public presence with respect to the project until project construction (e.g. through negotiation of land and easements, establishment of benefit sharing arrangements and the statutory planning and environmental approvals process); and
  - Aligning responsibility for community engagement and authority for making key decisions in one accountable party.

  For example, the Victorian Transmission Investment Framework Preliminary Design is considering how VicGrid – as a jurisdictional body - can play a formal role in building stakeholder acceptance for transmission projects. This includes supporting the tenderer when engaging with local communities, as well as introducing new planning tools to help reduce community concern over the lifespan of a project.

  These arrangements can greatly assist in facilitating genuine engagement with both landowners and the broader community.

3. Maximising the net-benefit of introducing contestability

AusNet understands the strawperson models have been developed to facilitate a discussion around the benefits and costs of introducing contestability at different stages, or for different functions, of the transmission planning and investment cycle.

With this in mind, AusNet has provided its perspective on the model features most important to maximising the net-benefits of contestability. We trust this will assist the AEMC in identifying a preferred strawperson model, acknowledging this model may be a variation on those presented in the Options Paper.

The preferred model should remove barriers to the non-incumbent tenderers competing on an equal basis with the PTNSP to maximise competitive tension, and its associated benefits

As a regular participant in competitive transmission tender processes within Victoria and interstate, AusNet is acutely aware that different models of contestability can create barriers to non-incumbent tenderers competing on an equal basis with the Primary TNSP. These barriers can negatively impact competitive tension and therefore reduce the overall benefits of contestability for consumers.

In order to create a level playing between all tenderers and maximise the net-benefits of contestability, we strongly recommend the AEMC:

- **Selects a preferred model that competitively procures the ownership; full range of enabling activities (construction, maintenance, and operations); and initial system strength services required to meet the identified transmission need. This maximises opportunity to market-test the end-to-end life-cycle cost of the upgrade.**

  The scope of contestable services (i.e. functions) has a material impact on a tenderer's decision to participate in a competitive procurement process and ability to compete on an equal basis with the Primary TNSP.

  Models which include the contestable provision of all services required to meet the identified need are likely to generate interest from a wider pool of tenderers and receive more competitive offers that maximise the net-benefits of competition through competitive tension.

  This is because:

  - ***The greater the scope of contestable services, the greater the opportunity for non-incumbent tenderers to out-compete the Primary TNSP***

    Models that only require contestable provision of construction and ownership (i.e. strawperson model 1) make it much more difficult for the non-incumbent tenderers to generate a material net-benefit to consumers compared to the counterfactual. This is because proponents are simply competing on their relative cost of finance, access to suppliers and relative capability to execute.

    In contrast, models that increase the scope of contestable services to include other services such as maintenance, operations, or essential system services allow non-incumbent tenderers to out-compete the Primary TNSP in multiple areas (e.g. innovation in design, delivery, maintenance schedules).

    It also allows non-incumbent tenderers to adjust different elements of their competitive offer to drive down whole-of-lifecycle costs. For example, given the costs of O&M services is largely driven by the cost of the capital solution, adjusting the solution design in a way that meets a project's requirements can significantly reduce O&M costs.

  - ***Non-incumbent network developers must seek a quote from the Primary TNSP for all services deemed non-contestable, at which point they are at a disadvantage to the Primary TNSP and may choose not to participate***

    In some models, the Primary TNSP is responsible for procuring services required to meet a project's identified need. This can include the provision of maintenance, operations or system strength required to securely operate the network once a project is commissioned and integrated within the existing shared network.

    In such models, non-incumbent tenderers are required to seek a quote for these services as part of their project tender response (rather than provide such services themselves). In these circumstances, the Primary TNSP faces fewer incentives to provide competitive terms to non-incumbent network developers or to consider their whole of lifecycle costs (as the competitive arm of the Primary TNSP's business is likely in direct competition with the non-incumbent tenderer). In addition, the Primary TNSP may not want to take on any risk from managing third-party owned assets. This can see the Primary TNSP offer a contract that takes either a worst-case approach to the future costs and passes them to the connecting party (e.g. assuming failure of

major components during its lifetime) or seeking to influence the design of the non-incumbent tenderer's solution (e.g. specifying assets to ensure extremely low failure rates or high maintenance costs).

These outcomes can place non-incumbent tenderers' offers at a significant disadvantage to the Primary TNSP (who can provide a consolidated solution), and encourage them not to participate in the tender process.

For the reasons above, AusNet's view is that operations, control and maintenance services should all be provided by the successful tenderer. In addition, any initial system strength services required to meet the identified project need should be provided by the successful tender without any changes to generator performance standards (GPS), with ongoing (subsequent) system strength requirements met by the Primary TNSP as applicable under the national electricity rules. We note this proposed approach to system strength is consistent with the NSW Electricity Infrastructure Investment (EII) Act model for system strength.

- **Carefully considers the level of prescription that should be applied to technical specifications as part of the detailed design of its preferred model**

  To deliver innovative design solutions (and their associated cost savings), tenderers typically respond to detailed technical parameters for the assets design, construction, operation, maintenance and interface with the shared network – also known as 'functional specifications.'

  There is a legitimate basis for the relevant planner-procurer to prescribe elements of its functional specification in detail (e.g. performance and safety requirements). However, setting these requirements too tightly can limit a non-incumbent tenderer's ability to develop an innovative design that leverages their experience and intellectual property.

  It is therefore highly important that the planner-procurer finds an appropriate balance that maintains minimum technical performance and safety requirements without 'over prescribing' technical specifications such that it precludes efficiency gains obtainable from innovative solution design. Benefits of contestability are highly sensitive to over-prescription.

  AusNet has provided its view on the key requirements that should be included in a functional specification in Appendix A, and welcomes the AEMC's consideration of this as part of the detailed design of its preferred model.

- **Considers whether a series of safeguards could be introduced as part of the detailed design of the preferred model**

  Our experience suggests that without safeguards that promote competition tension there is a risk that the contestable process is perceived principally as a mechanism to improve terms with the Primary TNSP. This can suppress the willingness of other non-incumbent tenderers investing in the costs of participating in the tenders, and therefore reduce the benefits of having a pool of tenderers competing for a project.

  To avoid these outcomes, we encourage the AEMC's detailed design work ensures the body responsible for planning and competitively procuring a project (e.g. AEMO, Jurisdictional Planning Body):

  - Provides equal access to and notification of relevant information (particularly during the network planning phase prior to tender).
  - Establishes clear parameters for the involvement of the Primary TNSP in the planning process, so to identify where their involvement could present them with a competitive advantage (e.g. involvement in preparatory works).
  - Avoids any requirements that force the network developer to disclose their capital solution, innovations or redundancy to the incumbent (e.g. a requirement for the non-incumbent tenderer to seek a quote for non-contestable services from the Primary TNSP rather than the procurer seeking them directly themselves).
  - Ensures the tender process is conducted early enough (and over a sufficient time period) to allow all tenderers to assess and respond to the planner-procurers requirements. For example, date of practical completion.

The preferred model should allocate planner-procurer responsibilities to the entity best able to execute those functions and incentivised to do so

As part of its "efficiency" criterion, the Options Paper acknowledges risks should be allocated to parties who are best placed to manage them and have incentives to do so efficiently. AusNet strongly supports the inclusion of this sub-criterion – its importance cannot be understated.

When reviewing the Options Paper's summary of key advantages and disadvantages of each strawperson option, it appears that this sub-criterion has only been applied with respect to the risk allocation and incentives of proponents.

In doing so, the Options Paper misses a critical assessment of who is the party best placed to act as the responsible planner-procurer. The planner-procurer is responsible for many of the functions that underpin the success of a contestable procurement model. This includes the timely and efficient planning of transmission infrastructure, building early community acceptance through proactive and respectful engagement and planning tools (e.g. strategic land use assessment), and conducting a tender and evaluation process which is transparent and cost-efficient.

AusNet's preference is that any preferred contestability model adopts a Jurisdictional Planning Body such as EnergyCo or VicGrid as its responsible planner-procurer. Key reasons include:

- Its functions, powers and objectives can provide flexibility to consider broader policy objectives (e.g. energy, climate and regional development objectives) for the transmission infrastructure investment beyond the national electricity objective (NEO) and therefore is a body with the legitimacy to arbitrate:
  - Extent to which transmission and generation development should be accelerated and how this should be achieved
  - How to conduct genuine engagement around the route, technology choices, benefits, costs and risks of hosting energy infrastructure with local communities, landowners and neighbouring property owners, and
  - The appropriate allocation of costs and risk between energy consumers and the proponent.
- Where planning or delivery risk is too great for consumers or proponents to bear in a stage of development, it has the financial capacity, flexibility and incentives to address and mitigate that risk (e.g. underwrite preparatory activities, support engagement with landholders and local communities, implement benefit sharing arrangements).

By contrast, AEMO is a not-for-profit entity, and operates strictly within considerations allowed within the NEO. It therefore does not possess the same legitimacy or capacity to arbitrate the above matters.

The approach to identifying projects most suitable for contestable delivery should provide transparency and certainty for both tenderers and the Primary TNSP

AusNet agrees that not all major transmission projects will be suitable to competitive delivery and that there are benefits to the AEMC exploring this question.

Our preference is for a prescriptive approach to identify projects suitable for competitive delivery. This recognises that:

- Criteria such as 'new', 'separable' and 'high value' are well understood concepts, and, when defined carefully, ensure contestability is applied to projects where the benefits are expected to outweigh any additional costs
- A prescriptive approach provides transparency and certainty to:
  - tenderers about the pipeline of projects that are contestable, and could increase the pool of tenderers interested in a major transmission project. This is particularly important for international tenderers who may have a limited footprint in Australia and would be required to invest significant time and resources to locate in our market.
  - The Primary TNSP so that they understand which projects they are responsible for procuring in full (e.g. projects below the contestability threshold or non-separable) or in part (e.g. non-separable elements of contestable projects).

Under current Victorian arrangements, the planner-procurer conducts a competitive tender process for major transmission projects where the cost is likely to exceed $10m (monetary threshold), and project is considered "separable" (i.e. results in distinct and definable service that will not have a material adverse effect on the Primary TNSPs ability to provide services to AEMO). These arrangements have remained unchanged since the mid-1990s and are currently under review through the Victorian Transmission Investment Framework Preliminary Design Consultation.

AusNet suggests that the AEMC carefully consider the definition of both the monetary threshold and separability so to maximise the net-benefits of contestability. In particular:

- **A monetary threshold of at least $100m indexed against CPI on an annual basis would capture large transmission projects that drive the greatest value for consumers.** This recognises that while the final value is, to an extent, subjective, $100m is a reasonable representation of a major transmission project, and projects of this value drive greater opportunity for innovation and increase attraction of competition from a broader pool of proponents.
- **A key determinant of separability is the level of interface works required to integrate a project within the existing shared network.** Some projects require more complex interface works than others before they are separable. Conducting preparatory works to establish a clean division between contestable and non-contestable network elements of a major transmission project will promote overall accountability for the transmission system and provide confidence to non-incumbent tenderers that they are competing on an equal basis with the Primary TNSP.

AusNet does not support adding in a second checkpoint that considers whether it is appropriate to proceed with a competitive procurement process for projects that are suitable for contestable delivery. Such measures are not required if a prescriptive approach is carefully defined to attract a competitive field of bidders. It also risks the timely and certain delivery of major transmission infrastructure – particularly if a project was to shift back to the regulatory framework having undergone a competitive procurement process.

Strawperson model 1 is inconsistent with many of the model features required to maximise the net-benefit of contestability, while model 4 fails on other requirements

The previous sub-sections provided AusNet's view on the model features most important to maximise the net-benefit of introducing contestability. These features have implications for the workability of straw person models identified in the AEMC's Options Paper.

Strawperson model 1 fails to deliver on several of these model features and is not suitable for further consideration. In particular, it does not competitively procure the full range of enabling activities (maintenance, operations and system strength) to maximise the opportunity for non-incumbent tenderers to out-compete the Primary TNSP. It is also too similar to the regulatory framework in its scope of contestable activities, and therefore fails to capture the full scope of benefits from contestability compared to the regulatory framework (e.g. cost savings available from innovation in design and delivery as well as whole of lifecycle cost optimisation).

In theory, Strawperson 4 is the model most able to leverage the benefits of contestability due to the greatest potential for innovation. However, in practice AusNet considers this model not suitable for future consideration. This is primarily due to:

- **The cost and complexity of implementing the reform**, which is dependent on significant changes to the current transmission planning processes (e.g. the ISP and RIT-T) and adoption by every NEM jurisdiction which is unlikely
- **The additional delivery risks in a framework where the planner-procurer tenders for an identified need.** There is a risk that proponents seek to conduct preliminary works and engagement activities with respect to their preferred major transmission project design, prior to the release of an identified need, to gain an advantage during a competitive process. This adds to a project's delivery risk, particularly if multiple parties are engaging with local community members and landholders.

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