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16 August 2022

Ms Anna Collyer
Chair
Australian Energy Market Commission
GPO Box 2603 Sydney
NSW 2001

Dear Ms Collyer

Re: AER submission to AEMC Transmission Planning and Investment Review - Contestability options paper

We thank you for the opportunity to comment on the Australian Energy Market Commission's options paper for the contestability work stream of the Transmission Planning and Investment Review (the Review). The Review is important to ensure the national regulatory framework is fit-for-purpose to support the significant transmission investment needed for the National Electricity Market's (NEM) current transition. The Australian Energy Regulator (AER) seeks to ensure that consumers pay no more than necessary for major transmission projects such as the actionable projects identified in AEMO's Integrated System Plan (ISP). We also consider it important that the regulatory framework promote the timely delivery of these major projects and certainty of investment where appropriate.

To this end, the AER welcomes the AEMC's consideration of contestability under the Review and the breadth of the strawpeople options set out in its paper. Contestability can address (or avoid) many of the issues identified with the regulatory framework, such as potential issues with the financeability of major transmission projects. A contestable transmission framework would, in principle, facilitate competitive provision of new infrastructure at efficient cost, in turn facilitating financeable investment.¹ Subject to its design, a contestable framework can also promote accurate cost estimates at the stage of evaluating and selecting a solution to a network need. This is because bidders will submit the total expected cost to deliver the option they have proposed, with the increased competition putting downward pressure on that cost.

¹ For the Thames Tideway Tunnel, Thames Water was able to have a large part of the work be delivered by a third party infrastructure provider via a licence. The winning bid, by Bazalgette Tunnel Limited, contained a BWACC of 2.497%, less than Ofwat's 3.29% and less than the 3.60% wholesale WACC from Ofwat's final determination for water and sewage companies. See: CEPA, Financeability of ISP Projects, Report for the AEMC, 8 January 2020, section 3.4.2; and Oxera, The Thames Tideway Tunnel: returns underwater?, 24 September 2015.

Moreover, contestability offers the potential to leverage the current NEM transition to maximise efficiencies for consumers. A contestable framework can best promote the innovation in solutions to network needs arising from the rapid pace of technological development we are currently seeing. KPMG's case studies of contestability in transmission, published alongside the AEMC's options paper, note evidence of cost savings driven by innovation in solution design and delivery:

- The winning solution for the Western New York Public Policy Transmission Project was approximately 22% below an estimate of the lowest cost incumbent bid.
- For the Hartburg-Sabine Junction 500kV project procured by the Midcontinent ISO, the winning proposal had a benefit-to-cost ratio of 2.2 (compared to a pre-tender planning estimate of 1.35).²

The unprecedented size (in terms of capital cost) of the discrete investments identified in the ISP should attract potential competitors, including overseas financiers such as banks or pension funds. KPMG's report notes the diverse range of bidders attracted to the tender process for the Central-West Orana Renewable Energy Zone (REZ) under the New South Wales (NSW) Government's Electricity Infrastructure Roadmap. This is despite that contestable model still being in its early stages.³ KPMG's report also contains evidence of the emerging trend under contestability models of joint ownership arrangements, which allows different resources, strengths and expertise to be leveraged.⁴ We recommend the AEMC's review seek to understand the potential interest from domestic and overseas parties to finance and deliver major transmission projects in the NEM.

We therefore consider now to be the opportune time to consider contestability in transmission investment in the NEM. As noted above, the approach is already gaining traction outside of the Review, with the NSW Government progressing its framework for the contestable delivery of infrastructure to support their REZs.⁵ The Victorian Government is also consulting on a contestable procurement process for its REZ transmission projects.⁶

AEMC's workstream timing and assessment framework

The AER notes the AEMC is adopting a staged approach to assessing contestability in transmission, in close consultation with stakeholders. The AEMC states that final recommendations on a broad model of contestability will be delivered in the first half of 2023 and, if recommended, a detailed assessment of the model commenced in mid-2023. We would be keen to explore with the AEMC how this workstream timing could be brought forward. We consider there is urgency to this reform, as the wave of transmission needed to support the energy transition has already started to be identified and delivered. Bringing forward the implementation of any contestability reform could therefore promote potentially significant efficiency benefits to consumers.

² KPMG, 'Contestability in transmission – international and domestic examples', Main Report, July 2022, p. viii.

³ KPMG, 'Contestability in transmission – international and domestic examples', Main Report, July 2022, p. 13.

⁴ KPMG, 'Contestability in transmission – international and domestic examples', Main Report, July 2022, p. 13.

⁵ NSW Government, Network Infrastructure Projects (Part 5 of the Electricity Infrastructure Investment Act 2020), October 2021.

⁶ Victoria State Government, Victorian Transmission Investment Framework – Preliminary Design Consultation Paper, July 2022, p. 38.

Further, the AER supports the AEMC’s assessment framework, but recommends it be amended to include the need for a whole-of-system approach to transmission planning (i.e. the outcomes of AEMO’s ISP). While we agree that any contestable model should be flexible enough to accommodate existing jurisdictional processes, at the same time we consider it important to promote national coordination in planning these investments to identify the least-cost development of the network needed to support the energy transition. Without this, we risk over-investment in the NEM, the costs of which will be passed on to consumers.

Recommended strawperson models for initial assessment

The AER strongly urges the fourth strawperson model be one of the options progressed to the AEMC’s initial high-level assessment under Part 1 of this workstream. As this model allows for the market to bid solutions to network needs identified in the ISP, we consider this option maximises the potential for innovation and, in turn, efficiencies for consumers. We also consider this model has the potential to promote the intent of the recently implemented actionable ISP framework⁷ if it can be demonstrated to improve AEMO’s identification and assessment of efficient solutions to network needs. We therefore consider this model warrants at least initial assessment, alongside any other shortlisted model, to understand the potential for these benefits to be realized in practice in the NEM.

In the options paper, the AEMC notes the potential for significant delays under this model. It is important to note, however, that the introduction of the competitive procurement process at the planning stage would be offset by the removal of existing regulatory assessments, such as the regulatory investment test for transmission and the AER’s contingent project assessment. This is because the nature of the regulatory assessment is expected to change under any contestability model. For example, the AER is currently developing guidance on the nature of its regulatory role in the contestable process under the *NSW Electricity Infrastructure Investment Act 2020* (the EII Act).⁸ Under the EII Act, the AER is required to make revenue determinations for Network Operators selected through a competitive procurement process to undertake network infrastructure projects in NSW. The AER’s role under that contestable process is different to our revenue determination process for network businesses under the National Electricity Law and National Electricity Rules. This is because competition between potential Network Operators is expected to produce an efficient, prudent and reasonable outcome. Our role under that contestable process will therefore be to assess whether the competitive procurement process is likely to produce an appropriate outcome, rather than reviewing in detail the components of a revenue proposal. The tender contract that is awarded to the successful bidder will become the regulatory framework, and the provisions within that contract can support and be consistent with the broader regulatory framework. The AER’s assessment under the contestable process for the EII Act will entail different timeframes and consultation to the existing revenue determination process. A contestable approach could therefore ultimately shorten the regulatory process for future transmission projects.

There have been challenges identified with the fourth strawperson model (i.e. the “sponsor-based” model) in PJM’s experience – the key one being difficulty in directly comparing bids that contain widely varying solutions to a transmission need.⁹ The AER considers there is merit in progressing this model to the next stage of the AEMC’s assessment to allow us to better understand the nature of such practical challenges and how they might be resolved. For example, it may be possible to develop standardised evaluation criteria to remove the lowest

⁷ National Electricity Amendment (Integrated System Planning) Rule 2020.

⁸ See AER, Revenue determination guideline for NSW contestable network projects – Draft (May 2022).

⁹ Joskow, Paul, Competition for Electric Transmission Projects in the U.S.: FERC Order 1000, March 2019, pp. 47 and 58.

value bids, to identify a smaller group of bids that can be considered in more detail. The AER is of the view that we do not understand the nature of such challenges well enough yet to rule out this model altogether.

KPMG's report will be a valuable reference, containing helpful evidence around important considerations such as the nature of regulation around competitively tendered projects as well as promoting network security. We know that availability incentives and deliverability thresholds for developers under the UK offshore regime have successfully promoted the high average availability for OFTO assets (99.19% since 2014).¹⁰ The next stage of the AEMC's assessment should help us better understand the practical considerations of the fourth strawperson model and therefore whether it is likely to maximise net benefits to consumers in practice.

The AER further considers that the strawperson models in the options paper are not necessarily mutually exclusive. It may be possible to design the framework for major transmission projects to allow project-specific circumstances to dictate which process (contestable or regulated) is best applied. For example, the nature of certain identified network needs may warrant an early competition process to identify different solutions from the market, while under the same framework another project is identified by the planner and a late competition model adopted instead. Threshold criteria can prescribe the best process to be adopted in different circumstances.

Conditions to promote effective competition

The AER offers the following initial comments on how the design of a contestable framework can promote effective competition. We consider these will be important features of a competitive procurement process, regardless of the model that is ultimately adopted:

- It is critical to protect the independence of the party assessing the bids or proposals. To this end, conflicts of interest (real or perceived) should be managed according to best practice for each step in the bid evaluation process. Any probity advisor should have similar independence requirements.¹¹
- A transparent process for communicating with the market during the request for proposals is important, to ensure all questions from the market and the answers (that are not identified as commercial in confidence) are provided to all interested parties.¹²
- A critical element of any tender process will be to assess the financial value for NEM consumers. Detailed and transparent tender rules, guidelines and evaluation criteria will be important to ensure the market provides high quality proposals that contain the necessary information for a robust evaluation.¹³

Even under a well-designed contestable framework, there may be instances in which the tender process does not result in effective competition. To protect consumers from high project costs in the absence of downward pressure from competition, the framework should provide for a "fallback option" where the tender process is deemed unsuccessful. For example, it might be appropriate for the competitive procurement process to cease and the regulatory process apply. This may include having the AER assess the efficiency of the

¹⁰ Ofgem, OFTO Regime Tender Process Decision Document (2021) p 19.

¹¹ Victorian Civil Construction Industry, Best Practice Guide for Tendering and Contract Management (May 2008) p. 25; Australian Constructors Association, Guidelines for Tendering (August 2006) p. 34.

¹² Victorian Civil Construction Industry, Best Practice Guide for Tendering and Contract Management (May 2008) p. 13

¹³ Department of Infrastructure and Regional Development, National Framework for Traditional Contracting – Topic Specific Guide 1: Project Definition and Tendering (September 2015) p 23.

proposed costs and applying cost efficiency incentives to the proponent, such as the Capital Expenditure Sharing Scheme.¹⁴ The risk of reverting to the regulatory process would arguably create an incentive on potential bidders to ensure that the competitive process is a success rather than seeing it revert back to the existing regulatory process.

Whilst it is significant reform, the AER considers contestability is worth considering as a potential long-term reform that can facilitate the efficient and timely delivery of transmission investment looking forward at the NEM's transition to net zero by 2050. We look forward to continuing working with the AEMC under the Review, including this workstream. To discuss any matter raised in this submission, please contact Arista Kontos on (08) 8213 3492.

Yours sincerely

A handwritten signature in blue ink that reads "Jim Cox". The signature is written in a cursive style with a large initial "J" and "C".

Jim Cox
Deputy Chair
Australian Energy Regulator

Sent by email on: 16.08.2022

¹⁴ AER, Better Regulation, Capital Expenditure Incentive Guideline for Electricity Network Service Providers, November 2013.