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18 August 2022

Rupert Doney
Project Leader
Australian Energy Market Commission
GPO Box 2603
Sydney NSW 2001

(via online submission)

Dear Rupert,

Transmission Planning and Investment Review
Contestability – Options paper (EPR0087) submission

Capella Capital Pty Ltd as agent for the Capital Capella Partnership (**Capella**) welcomes the opportunity to make a submission to the Australian Energy Market Commission (**AEMC**) on the Options Paper dated 7 July 2022 for the contestability workstream of the Transmission Planning and Investment Review (the **Review**).

Capella is a market-leading infrastructure developer, investor, financial adviser and asset manager in the infrastructure and PPP sector. With over $32b of infrastructure projects in the last twelve years, Capella consistently provides innovative solutions for consortia and State clients.

Capella provides whole-of-Project continuity; from origination, equity investment to asset and funds management; extending relationship and deliverability certainty to its partners and clients. Capella actively manages nine Project Co vehicles, currently at varying stages of construction and operations, working side-by-side with governments, partners and stakeholders in a truly collaborative manner. Capella proudly provides the highest quality teams, with a detailed technical understanding of the project to successfully deliver on its contract promises.

Capella supports the important work being undertaken by the AEMC to assess the costs and benefits associated with increasing contestability in the provision of major transmission projects in the NEM. This work is critical and will shape the approach to major transmission projects investment in years to come as Australia shifts towards net zero.

At a high level, Capella supports increasing contestability in the delivery of major transmission projects and believes there are significant opportunities to increase net benefits to consumers under a contestability model. Capella is currently bidding with the ACE Energy consortium on the Central-West Orana renewable energy zone (**REZ**) tender in NSW. We would support a contestability model similar to the REZ, in particular, consisting of design & construction, finance and own and operations and maintenance. We believe such model delivers whole-of-life benefits, provides certainty and maximises competition. Capella's response to the Contestability - Options paper is attached.

We very much value the opportunity that the AEMC has provided to enable us to provide input into this process. We look forward to the opportunity to engage further with the AEMC. Should you wish to discuss this submission further, please don't hesitate to contact me.

Yours sincerely,

Benjamin Mark

Ben Mark
Director
Capella Capital

Attachment: Capella Capital submission

1. CONTESTABILITY STRAWPERSON MODELS

Capella acknowledges the four Strawperson Models of contestability being considered by the AEMC and identified in the Options Paper. We recognise the potential for each Strawperson Model to work in the NEM and their associated challenges, opportunities, and trade-offs. Our view is that a late model of competition in the form of Strawperson Models 2 and 3 would best deliver net benefits to consumers and therefore should proceed through to the AEMC's high-level assessment.

The key advantages applicable to Strawperson Models 2 and 3, relative to other Strawperson Models, include delivering increases competition, increased opportunities to access efficient capital markets, improved whole of life outcomes, and procurement efficiencies and timeliness. We have also set out our initial comments on the key advantages and disadvantages as described in the Options Paper in Section 4.

1.1 INCREASED COMPETITION

As noted in the Options Paper, Strawperson Models 2 and 3 would involve either a jurisdictional body or AEMO, respectively, developing reasonably detailed specifications for the services and assets that are subject to the tender. This approach is likely to increase market interest in the procurement as such approach will reduce bid costs exposure and tender timeframes for tenderers in comparison to an early model of competition such as Strawperson Model 4 which involves the identification of a need defined at a high level, while still encouraging innovation. Our experience shows that high bid costs and long tender timeframes are a material barrier to competition and reduces market appetite, therefore any approach that reduces these costs will be welcomed by the market.

The significant market interest in the comparable Central-West Orana Renewable Energy Zone procurement as demonstrated by the receipt of nine registrations of interest, demonstrates the attractiveness of Strawperson Models 2 and 3 to the market and in particular from parties with infrastructure development capability. We do not believe there would be a similar market response from Strawperson Model 1 and 4.

1.2 EFFICIENT CAPITAL PROVIDERS

Our view is that the similarities between Strawperson Models 2 and 3 and the public private partnership (PPP) model used in the procurement of public infrastructure provides opportunities to access a greater pool of low-cost private capital from project finance markets. As evidenced by the numerous PPP and infrastructure projects, there is significant volume in project finance debt and equity capital markets. Our view is that Strawperson Models 2 and 3 are best placed to access these markets, increasing competition and reducing the cost of capital, ultimately benefiting consumers.

Furthermore, PPP private capital providers are also experienced with project structures that involve no revenue during construction and understand the importance of alignment with long term project objectives. This can result in improved terms and a better commercial outcome for stakeholders.

1.3 WHOLE OF LIFE BENEFITS

Through our experience, we note the importance of whole of life considerations in the successful long term delivery of infrastructure and maximising cost efficiencies. The responsibility of the selected tenderer to undertake construction, finance, together with operation and maintenance activities under Strawperson Models 2 and 3 provides bidders with the opportunity to efficiently balance upfront construction costs with the costs associated with the long term operation and maintenance of assets to deliver the optimal whole of life cost. This consideration can encourage tenderers to ensure efficient long term asset performance and resilience rather than a narrower focus on short term costs that could lead to gold plating or underspending. If incentivised appropriately through the tender process, a whole of life approach that is possible under these models provides a degree of protection for consumers from the costs and issues associated from gold plating or underinvestment and promotes solutions that support long term asset health, while maximising cost efficiencies over the long term.

1.4 PROCESS EFFICENCIES & TIMELY DELIVERY

Given Strawperson Models 2 and 3 involves procurement at a later stage in the project procurement lifecycle, this naturally will result in more developed project objectives and requirements at the time it is released to market, when compared to other early stage competition. Having more detailed project requirements reduces uncertainty for bidders and greatly supports the timely delivery of major transmission projects. Providing tenderers with detailed requirements reduces complexity, the risk of re-work, misinterpretation of scope, uncertainty due to assumptions changing over time and also associated costs and delays which could result from an early competition model (such as Strawperson Model 4).

The allocation of responsibility between the jurisdictional body and the tenderer under Strawperson Models 2 and 3 is also similar to that used in the PPP model. As the PPP procurement model has developed and matured, procurement documents, risk allocation between the parties, processes and timeframes have become more standardised and efficient. We believe that Strawperson Models 2 and 3 will also benefit from such standardisation as more projects are brought to market and awarded. This will support the achievement of the decarbonisation timeframes.

1.5 LIMITATIONS TO STRAWPERSON MODELS 1 AND 4

Capella recognises that Strawperson Models 1 and 4 also include distinct net benefits for consumers. However, our view is there are drawbacks to these models that would likely results in an inferior outcome as compared to Strawperson Models 2 and 3.

Our view is that Strawperson Model 1 reduces the scope for innovation, whole of life opportunities and limits the selected tenders ability to support long term asset performance and resilience. This is due to:

- The limited role for the selected tenderer to perform operation and maintenance activities following construction of assets which incentivises short term behaviour
- Potential misalignment of objectives and coordination complexity between the jurisdictional body, selected tenderer and the PTNSP. This is as the operation and maintenance activities would be the responsibility of the PTNSP rather than the party that is constructing the asset

With regards to Strawperson Model 4, our view is that whilst the proposed early model of competition approach may provide additional opportunities for innovation, it could

- due to the very limited number of likely participants that have the appetite, resources and expertise to tender this model, resulting in a poor competitive process
- increase complexity, bid costs and uncertainty for bidders in comparison to other Strawperson Models, reducing market appetite
- increase the risk of re-work or changes following tender submission given likely longer procurement timeframes, resulting in delays and potential increased costs for consumers.

2. ASSESSMENT FRAMEWORK

Capella acknowledges the six assessment criteria considered and agrees that there are inherent trade-offs associated with selecting a suitable Strawperson Model. Identifying the objective provides transparency for developing the assessment framework which promotes the Commission's purpose of seeking feedback and general market engagement.

Capella recognise that the considerations are dynamic, therefore the importance of each consideration would change with the market over time. While the Commission continues to undertake this Contestability workstream, we would welcome the opportunity to further consider and provide feedback on the assessment framework once it is more progressed.

In general, we view certainty (i.e., certainty of transmission projects being delivered to the required standard and time to meet the needs), cost effectiveness (i.e., maximising net benefits to consumers) and maximising competition as key criteria that should be prioritised. Prioritising these considerations should assist the Commission in weighting the six criteria.

Given the Commission's aim to improve the social licence we suggest the following also be considered as part of the assessment framework. These will assist in broader positive impacts on local businesses and communities.

- ***Market and workforce development.*** Ability to increase and support the capability and capacity of the local industry including building and facilitating skills transfer. Providing communities with the skillset and a pipeline of project to apply it significantly improves the standard of living of people therefore increases the social license. It would also assist in developing the skillset within the market which can be leveraged for the pipeline of future projects. Ultimately proving significant cross pollination benefits between the project identified in the ISP.
- ***Social procurement***. Ensuring opportunities are provided to vulnerable community groups to improve equity. The groups can include but are not limited to Indigenous communities, people with disability, job seekers, women, people of diverse cultural backgrounds, people in regions with limited access to jobs, and promoting environmentally sustainable practices.
- ***Stakeholder management***. Ensuring that the selected Strawperson Model has an incentive towards effectively managing stakeholders. This should include identifying key stakeholders and their issues and rectifying any concerns throughout the process and into operational period to manage the social license with a longer-term view.

3. IDENTIFYING PROJECTS SUITABLE FOR CONSTESTABLE DELIVERY

Capella welcomes the Commission's approach to considering the most suitable method to determine the projects for competitive delivery. Capella has presented its view on the criteria / principles and decision-making process that should be considered in identifying a suitable sub-set of major projects to undergo competitive delivery. The views presented should assist the Commission to understand the factors that encourages competition.

3.1 CRITERIA / PRINCIPLES

A key objective of selecting the Strawperson Model is to ensure it drives competition. Capella's experience in various infrastructure sectors has shown that to drive competition in a subsector, the types of projects subject to contestable delivery should be attractive to the market.

Our view on the criteria / principles that should be considered in identifying the major transmission projects that would be most attractive to the market include:

- ***Set a minimum dollar amount threshold***. Larger projects (comparable to recent transactions such as Central West REZ) are more attractive to the market, attracting larger market interest and competition, resulting in greater net benefit to the consumer.
- ***Ensure project is separable***. A separate project is simpler, more attractive and assists in management of the risk allocation and therefore maximises cost efficiencies. This maximises the participation of market players as there is the notion that there is less incumbent advantage and less interface risk.
- ***Undertake detailed market engagement***. Directly engaging with the market and seeking feedback across a range of project issues allows the Commission to obtain confidence that when the project is formally tendered on there will be significant appetite from the market to undertake a competitive procurement process. We recommend the Commission undertake this engage as early as possible to ensure the market is aware of the opportunity and can plan and respond appropriately.

3.2 APPROACH TO DECISION MAKING (PRESCRIPTIVE VS DISCRETIONARY)

Capella consider if certain criteria / principals are met (refer discussion in 3.1), then the relevant project should continue to a contestable procurement process. There should only be a very limited number of exclusions (if any) that should prevent the relevant project from going into a competitive process. The exclusions would require it to be project specific such a lack of market appetite due to prevailing project specific issues.

Capella's view is that a hybrid approach, as described above, provides certainty to the market by providing a predictable pipeline of projects. This allows market participants to anticipate workload, manage resourcing capacity and invest in tendering which ultimately provides the depth in the market required for an efficient transformational shift in the energy market. It enables a contestable process to be undertaken which maximises net benefit to the consumers. Therefore, the use of discretion (if any) should be limited to minimise impact on market confidence.

4. STRAWPERSON MODEL ADVANTAGES AND DISADVANTAGES

Capella acknowledges the various advantages and disadvantages associated with the Strawperson Models, the assessment criteria and their trade-offs. Please see below our thought on the key advantages and disadvantages associated with the four Strawperson Models below from the Options Paper.

4.1 STRAWPERSON MODEL 1

EFFICIENCY

- *'Contestability is limited to functions that are already contestably procured by PTNSPs in practice, so not clear if it will deliver additional efficiency benefits compared with the counterfactual'*: we agree that given the limited contestability elements in option 1 compared to other options, that additional efficiency benefits would be limited. Cost efficiencies and innovation are optimised where tenderers can consider whole-of-life benefits across construction, finance, own and maintenance under the other options.
- '*Less scope for improvements in innovation or other aspects of efficiency than other options*': as above, we agree there would be less scope for innovation under this option.

ACCOUNTABILITY

We note there could be misalignment of objectives as well as interface and coordination complexities for the jurisdictional body, selected tenderer and PTNSP associated with separating construction and maintenance, which may not lead to optimal outcomes.

4.2 STRAWPERSON MODEL 2

TIMELINESS

- We would add the potential for a 'fixed price / fixed time' contract as a key advantage.
- It is not clear what the 'complexity and coordination challenges in allocation of responsibility' are referring to, and we would welcome further discussions on this point.

EFFICIENCY

- We agree with the advantages, in particular, there is potential for significant cost savings through a competitive process, whole-of-life assessment and through an appropriate risk allocation.
- '*Scope of potential efficiency benefits is unclear given detailed design, construction and financing are already contestably procured by PTNSPs in practice and make up the majority of the costs of major projects*': we reiterate the benefits associated with a whole-of life assessment which considers all of design & construction, financing and operations and maintenance.
- *'Service performance incentive arrangements could be more complex as there is not a single party responsible for reliability'*: this concern could be mitigated through clear allocation of responsibility.
- *'Multiple parties responsible for connections could lead to longer connections processes and increased complexity of connection agreements for generators'*: this concern could be addressed via interface arrangements.

ACCOUNTABILITY

- We agree with the advantages.
- *'Split accountability for design, construction and maintenance of different parts of the network, and a separation between operation of individual parts of the network and control of the overall system. Would require complex NER provisions and contractual'*: As noted above, a clear allocation of responsibility could mitigate a number of these concerns.
- '*Split accountability for connections would lead to increased complexity. Would also no longer be a single party that can contract with connecting generators and loads to provide them with a connection and use of system service for the entire transmission network, which would need to be addressed through new NER or contractual mechanisms*': With the PPP model, we have seen the successful use of interface arrangements to manage rights and obligations of various parties.

IMPLEMENTATION

- We agree that drawing on existing Australian jurisdictional precedents would be a key advantage to support implementation of this option.
- '*Would require a lengthy consultation, design and implementation process – would likely be several years before the changes could commence*": The length of the process would be mitigated by drawing on existing Australian jurisdictional precedents, including the current REZ procurement and elements of the PPP model used in the delivery of public infrastructure.

DECARBONISATION

- We agree with the advantages. We also note the ability to run concurrent procurement processes and / or back-to-back procurement processes could accelerate the path to decarbonisation.
- '*Could slow down the pace of decarbonisation if the contestable delivery process increases the time taken to deliver projects and time cannot be saved elsewhere*': The length of procurement process would be mitigated by drawing on existing Australian jurisdictional precedents, including the current REZ procurement and elements of the PPP model.
- '*Increased complexity and coordination challenges in allocation of responsibilities could lead to some delays to transmission projects and/or generator connections, which could slow the pace of decarbonisation of the energy sector*': As discussed above, a clear allocation of responsibility and interface arrangements could mitigate these challenges.
- Furthermore, as the model is adopted and matures, time and cost efficiencies could be realised from the standardisation of documents and processes

4.3 STRAWPERSON MODEL 3

TIMELINESS

- We would add the potential for a 'fixed price / fixed time' contract as an advantage.
- It is not clear what the 'complexity and coordination challenges in allocation of responsibility' are referring to, and we would welcome further discussions on this point.

EFFICIENCY

- We agree with the advantages, in particular, there is potential for significant cost savings through a competitive process, whole-of-life assessment and through an appropriate risk allocation.
- '*Scope of potential efficiency benefits in unclear and financing are already contestably procured by PTNSPs in practice*': we reiterate the benefits associated with a whole-of life assessment which considers all of design & construction, financing and operations and maintenance.
- '*Service performance incentive arrangements could be more complex as there is not a single party responsible for reliability'*: this concern could be mitigated through clear allocation of responsibility.
- '*Multiple parties responsible for connections could lead to longer connections processes and increased complexity of connection agreements*': this concern could be addressed via interface arrangements.

ACCOUNTABILITY

- We agree with the advantages.
- '*Split accountability for design, construction, operation and maintenance of different parts of the network, but risks are mitigated by AEMO's role'*: As noted above, a clear allocation of responsibility could mitigate a number of these concerns.
- '*Accountability for engagement is split, but this risk could be minimised by combining this option with a new jurisdictional body that is responsible for aspects of these issues as Victoria is doing with VicGrid*': With the PPP model, we have seen the successful use of interface arrangements to manage rights and obligations of various parties.

IMPLEMENTATION

- We agree that drawing on existing Australian jurisdictional precedents would be a key advantage to support implementation of this option.

DECARBONISATION

- We agree with the advantages. We also note the ability to run concurrent procurement processes and / or back-to-back procurement processes could accelerate the path to decarbonisation.
- '*Could slow down the pace of decarbonisation if the contestable delivery process increases the time taken to deliver projects and time cannot be saved elsewhere*': The length of procurement process would be mitigated by drawing on existing Australian jurisdictional precedents, including the current REZ procurement and elements of the PPP model.
- '*Increased complexity and coordination challenges in allocation of responsibilities could lead to some delays to transmission projects and/or generator connections, which could slow the pace of decarbonisation of the energy sector*': As discussed above, a clear allocation of responsibility and interface arrangements could mitigate these challenges.
- Furthermore, as the model is adopted and matures, time and cost efficiencies could be realised from the standardisation of documents and processes

4.4 STRAWPERSON MODEL 4

TIMELINESS

- '*Contestable procurement process could increase the time required to deliver projects unless it saves time elsewhere in the investment process (eg the procurement process would replace the current AER contingent project process)*': we would add that the procurement process under this option could be the longest and most uncertain given the process commences at a very early stage and scope is less defined.
- It is uncertain whether tenderers would be able to bid a fixed price given the long procurement timeframe. Bids are likely to contain more variables and assumptions. There is also a risk that tenders need to be revisited if those variables / assumptions change following tender submission, increasing overall tender timelines

EFFICIENCY

- '*Likely increase in the bid costs and risks for proponents participating in this model compared to other options*': while we acknowledge the potential for increased innovation, we agree that bid costs and risks (i.e. re-work) are likely to be higher under this option. The procurement process is likely to be more complex with more variables compared to other models. As a result, this is likely to reduce market appetite for this model and ultimately reduce the cost efficiencies that could be achieved through a contestability model.
- In addition, could result in high costs compared to other options if tenderers are taking on greater risk, with disproportionate risk allocation.

IMPLEMENTATION

- We agree this process would require the longest consultation out of the models proposed. We also expect challenges in establishing assessment criteria and evaluating tenders given solutions from tenderers could be very different.

DECARBONISATION

- Refer to our comments above on 'Timeliness'. Given the longer procurement timeframe and potential risk of changes in variables / assumptions following bid submission, this could put the decarbonisation timeframes at risk.