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Thursday, 3 November 2022

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

Submitted online: www.aemc.gov.au

Dear Ms Collyer,

Transmission Planning and Investment Review- Stage 3 Draft Report -

Thank you for the opportunity to respond to the Australian Energy Market Commission's (AEMC) draft report on Stage 3 of its Transmission Planning and Investment Review. We support the AEMC's examination of regulatory reform to support certainty and enable the timely and efficient delivery of the required transmission infrastructure as Australia transitions to a low carbon future.

Transgrid supports the acceleration of transmission planning, approval and delivery and the AEMC's review examining how the regulatory framework can support this objective. In this context, Transgrid also supports the removal of duplication and overlap in the current economic assessment process for major transmission projects. This would result in a more streamlined process while also maintaining the appropriate level of rigour, which is essential for energy consumers.

Transgrid recognises the pivotal role that the Federal Government's Rewiring the Nation policy will play in supporting the delivery of the transmission infrastructure required in the National Electricity Market. As such we support changes to the National Electricity Rules which enable the benefits of any Federal Government financing under this policy to be appropriately passed on to consumers. It is critical that the changes to the National Electricity Rules also provide certainty to transmission network service providers as they embark on delivering the significant amount of transmission investment required. We see the timely effect of these changes to be critical to delivering the ISP projects in a timely and efficient way.

In respect to the proposed *timely delivery incentive*, Transgrid does not consider this necessary and is concerned that such a mechanism could inadvertently impair the timely delivery of transmission, which is not in the best interests of consumers.

Transgrid looks forward to continuing to work with the AEMC to develop a regulatory framework that expedites the significant and urgent investment that is required in new transmission infrastructure. If you require any further information or clarification on this submission, please contact me or David Feeney at david.feeney@transgrid.com.au.

Yours faithfully

Maryanne Graham
Executive General Manager – Community and Policy

Transmission Planning and Investment Review – Stage 3

Transgrid submission to the AEMC's Draft Report

Summary

This submission provides Transgrid's response to the Australian Energy Market AEMC's (AEMC) Stage 3 Draft Report (Draft Report) as part of its Transmission Planning and Investment Review, which was published on 21 September 2022.

Transgrid supports changes to the National Electricity Rules (NER) which support certainty and enable the timely and efficient delivery of the transmission infrastructure required as Australia transitions to a low carbon future.

Our submission is structured as follows:

- Section 1 sets out our views on the AEMC's draft recommendations on streamlining the economic assessment process.
- Section 2 covers our views on the transmission planning framework in the NER and emissions abatement.
- Section 3 details our views on the treatment of concessional finance in the NER.
- Section 4 covers our response to the AEMC's proposal for a Timely Deliver Incentive (TDI) to address its concern that transmission network service providers (TNSP) have an exclusive right but no obligation to invest.
- Section 5 sets out our views on managing cost risk and uncertainty in the ex-ante framework.

1. Streamlining the economic assessment process

1.1. The AEMC's view

The AEMC outlines a spectrum of options to address some stakeholder concerns in relation to the economic assessment process and to support the timely delivery of transmission investment, while balancing rigour. These are:

- **Option 1** – Front loading early works: Existing process remains largely in place with amendments focussing on bringing early works forward.
- **Option 2 –** RIT-T focusses on option development, Australian Energy Market Operator (AEMO) responsible for net benefit assessment through ISP:
- **Option 3** – ISP undertakes centralised assessment of costs and benefits, with input from TNSPs.

The AEMC is seeking feedback on whether any of these options should be taken forward for further development and assessment or if they should be considering any other options, including variations or hybrids of the three options presented above.

1.2. Our response

Transgrid's view is that there is a degree of overlap in the activities and decisions that are being made at each stage of the economic assessment process and hinders the ability for transmission projects to be delivered on a timely basis to meet market expectations. The current economic regulatory process was put together at a time where the pace of change was different. To meet renewable targets and the needs of consumers, transmission needs to be built at a much faster pace than the regulatory framework currently allows. While Transgrid supports streamlining the economic assessment process, there also needs to be an appropriate level of rigour so consumers have confidence in the economic assessment process.

In this context, Transgrid supports option one as outlined in the AEMC's Draft Report. Under this option, all existing elements of the counterfactual economic assessment process remain in place, namely the ISP, the RIT-T, the feedback loop, and the contingent project assessment. The primary difference to the current process is that during the RIT-T process, the TNSP would undertake early works with funding certainty.

This could include:

- Engagement with local communities, landowners and other stakeholders,
- Community benefits.
- Procuring equipment with long lead times which are required across all credible options.
- Pre-contracting activities for engineering procurement and construction contracts such as obtaining binding bids.
- Obtaining all primary planning and environmental approvals, licences and permits.
- Substation site selection, easement acquisition and preparation of option agreements with landowners.
- Construction works necessary to test the design of the physical infrastructure components.

This will provide TNSPs with funding to undertake early works concurrently with the RIT-T and thus improve the cost certainty of a project earlier in the process, as opposed to waiting until the conclusion of the RIT-T and feedback loop process for greater cost certainty. The front-end loading risk of large transmission projects will be minimised.

TNSPs have the planning, customer and local expertise and are best placed to undertake the necessary system and market modelling for assets that will connect to their network. Given this, we believe option 2 and option 3, are unable to deliver the appropriate rigor without greater TNSP involvement. If option 2 or option 3 were chosen, then the role of a TNSP in the ISP process would need to be expanded to include responsibility system modelling and planning in their respective states. TNSPs would need to have this expanded role codified in the NER or relevant guidelines. This would also allow TNSPs to be more responsive to consumer needs whilst jointly working with AEMO as partners in the ISP process rather than only providing advice on an as need basis.

Non-ISP projects

While Transgrid supports the AEMC's focus being on ISP projects in Stage 3 of its Transmission Planning and Investment Review, we would like to bring to the AEMC's attention issues which exist in the current framework for non-ISP projects, in particular projects that are driven by spot load connection/growth. These projects typically need to be delivered in a short timeframe.

In particular, the existing regulatory approval process represents a barrier for delivering transmission projects that requires financial commitment from the load customer. The current guidelines require a load to be fully financially committed before a TNSP can start a RIT-T process. However, for a load to be financially committed they require the TNSP to confirm they will provide the transmission asset that is required by them to connect. The RIT-T typically requires new load to lead network expansion, creating a 'chicken and egg' dilemma: new load projects cannot be committed without transmission, but proactive transmission expansion is not supported under the current regulatory framework without load financial commitment. Investors will only commit to an investment once they have assurance of a network they can reasonably connect to, and which will provide energy.

Further to this, when a load is committed, Transgrid is expected to deliver the connection works within one to two years. This is unlikely to be met considering it takes two and half years for small asset augmentation and up to 6 years for larger projects that have transmission lines. This time includes completing the current RIT-T process and completion of design works and build.

Our view is that there needs to be adjustments to the load commitment requirements to enable timely delivery of connection works. This would include allowing TNSPs to start the RIT-T process once the load in the advanced stages of their connection process, for example when they have submitted an application to connect to the DNSP and have a firm need date for power supply.

2. Emissions abatement

2.1. The AEMC's view

The AEMC sets out that emissions abatement is currently factored into transmission planning. It states it will continue to monitor developments with respect to climate legislation and an emissions objective in the national electricity objective (**NEO**) to ensure that emissions abatement continues to be appropriately factored into transmission planning in the future.

2.2. Our response

Transgrid supports the AEMC continuing to monitor developments with respect to climate legislation and an emissions objective in the NEO and considering how changes may be required to the transmission planning framework as a result. We agree with the AEMC that it may be appropriate for emissions abatement to be explicitly valued in the ISP/RIT-T regardless of whether there is a formal price on emissions in Australia. The AEMC should also ensure that the transmission planning framework enables emissions reductions benefits from different assets providing transmission and related system services, and different construction materials, to be recognised as well as the emissions reductions benefits relating to the connection of new low emissions supply sources.

3. Concessional finance

3.1. The AEMC's view

In the context of the Federal Government's Rewiring the Nation policy, the AEMC considers additional guidance in the NER would be beneficial to clarify how concessional finance is to be treated. In particular, the AEMC is keen to ensure the NER can allow the benefits of a concessional loan to be allocated based on the intended purpose of the loan.

3.2. Our response

3.2.1. The issue

Transgrid supports any changes to the NER required to support the timely and effective delivery of the Federal Government's Rewiring the Nation policy, which may include the granting of concessional loans to TNSPs for transmission investment.

We agree with the AEMC that providing upfront clarity to TNSPs, financiers and the Federal Government on the treatment of any concessional loans in the regulatory framework is in the interests of those parties, as well as consumers who rely on the timely delivery of the infrastructure that the loans would support.

Broadly, consumers can benefit from concessional financing for transmission investment by both:

- Enabling commercial viability issues to be overcome to allow investment to proceed, and thereby facilitating lower wholesale prices for consumers.
- Reducing the cost of the investment for consumers, thereby directly resulting in lower prices for consumers than would have otherwise been the case.

Our view is that the NER sufficiently allows the first of these two outcomes to occur currently, that is the NER sufficiently enables a TNSP to receive the benefits of the concessional loan to overcome commercial viability issues currently. This is the default setting in the NER.

However, our view is that that the NER would benefit from additional clarity in relation to the second outcome, that is how the benefits of a concessional loan are to be directly passed through to consumers where this was the intent of the parties entering into the agreement.

We note that the detail of the concessional loan arrangements is not known at this stage. The purpose of the loan could conceivably include a mixture of both outcomes. As the AEMC observes, each of the two outcomes above are not mutually exclusive.

3.2.2. The solution

3.2.2.1. The framework for the treatment of concessional loans

To foster greater clarity, our view is that the following changes should be made to the NER.

- The NER should require the AER's regulatory treatment of the concessional loan to be as advised by the TNSP, and as documented in any agreement between the TNSP and funding body. It is essential that concessional financing is only viewed as "concessional" where it is explicitly stated and contracted on that basis. In all other cases, the current arrangements in the NER should apply.
- TNSPs should be required to inform the AER on precisely how the benefits of the concessional loan are to be treated, including the relevant mechanism in the regulatory framework through which this would be achieved, as agreed between the TNSP and the funding body.

To support this approach, the NER should also enable the AER to seek the relevant parts of the contract entered into between the parties from the TNSP on a confidential basis.

This approach appropriately relies on the agreement between the parties, which is essential to provide the certainty required for TNSPs as they embark on the significant transmission investment required in the National Electricity Market. This approach does not provide the AER with any discretion in undertaking its role as we do not see that any discretion for the AER is required if the relevant parties contract with sufficient clarity.

If the agreement between the contracting parties is not clear on how a concessional loan is to be treated by the AER, the NER should require the AER to consult with both parties to the agreement together. We do not support the AEMC's suggestion that the NER require the AER to enter one-on-one discussions with the funding body to determine the intent of the concessional loan, given this excludes one of the parties to the contract. More generally, Transgrid anticipates it would brief the AER on any concessional financing arrangements as discussions progress.

3.2.2.2. The mechanism for passing benefits directly to consumers

Our view is that the NER should also provide clarity on the different mechanisms in the regulatory framework that can be used for passing on the benefits of a concessional loan directly to consumers. The NER should allow the fullest possible range of mechanisms given they each may have a different impact on the timing of the flow of benefits. The parties entering into the concessional loan agreement can choose the mechanism which most closely meets their needs.

In particular, the NER should allow for:

- Treating the benefit of the concessional loan as a capital contribution.
- Making an adjustment to a TNSPs MAR to reflect the benefit of the concessional loan.
- Making an adjustment to a TNSP's prices to reflect the benefit of the concessional loan.

We note an adjustment to a TNSP's prices may also make the consumer benefit of any concessional loan under the Federal Government's Rewiring the Nation policy more transparent than under the other mechanisms. It is not clear that the NER can currently facilitate the use of each of these mechanisms to pass through the benefits of a concessional loan to consumers.

3.2.2.3. Taking concessional financing into account in the ISP and in RIT-T

The AEMC also seeks views on whether concessional financing should be recognised by AEMO in the development of the ISP and by TNSPs in undertaking RIT-Ts for major transmission projects.

Our view is that where concessional financing and its intended purpose is known at the time, it can be recognised in the ISP and RIT-T. However, we note that this information may not be known at this stage.

3.2.2.4. Transitional arrangements

The NER should also provide for appropriate transitional arrangements to account for agreements already entered between TNSPs and Government funding bodies, or where negotiations are already underway. To enable the success of the Federal Government's Rewiring the Nation policy, it is essential to ensure that benefits of these concessional loans can effectively and transparently flow directly through to consumers where this is the intended purpose agreed to between the parties.

4. Managing the exclusive right but no obligation to invest

4.1. The AEMC's view

The AEMC is concerned with TNSPs having an exclusive right but no obligation to invest in major transmission projects. In response to this concern, the AEMC's draft position is to introduce a new incentive mechanism – the Timely Delivery Incentive (**TDI**). The TDI, if introduced, would impose a financial incentive on a TNSP to make an investment decision and deliver the project in a timely manner, with reference to milestone dates or a final delivery date.

4.2. Our response

4.2.1. The issue

Transgrid's view is that the decision to invest should reside with the TNSP making the investment. Absent any financeability issues, there is no reason to believe that TNSPs would not proceed with investments in ISP projects.

As indicated by the AEMC, mechanisms to address concerns around financeability are being actively considered and progressed by policy makers:

- As the AEMC outlines, some of the reforms it is proposing in Stage 2 of its Transmission Planning and Investment Review may help to assist in resolving any financeability issues for TNSPs. We note the AEMC's Stage 2 draft recommendation to enable the AER to amend depreciation profiles to address any financeability issues.
- Concessional loans provided by the Federal Government as part of its Rewiring the Nation policy, as discussed in section 2 of this submission, could also assist addressing any financeability issues for TNSPs.
- Transgrid is also working closely with the AER to identify existing mechanisms in the NER which may be used to help address any financeability issues for TNSPs.

In addition, as pointed out by the AEMC, the NSW Energy Minister can declare Priority Transmission Infrastructure Projects in NSW and direct Transgrid to deliver these projects. This power is conferred on the NSW Energy Minister in the Electricity Infrastructure Investment Act 2020 (NSW).

Taken together, our view is that these reforms obviate the need for a TDI in the NER.

There is also no evidence TNSPs do that do not have an incentive to deliver an ISP project in a timely fashion once the TNSP has committed to the project. Transgrid is currently scheduled to deliver the ISP projects it has committed to in a timely manner. This includes Powering Sydney's Future (expected completion 2022), Queensland to New South Wales Interconnector (expected completion 2022), Victoria to New South Wales Interconnector (expected completion 2022), Energy Connect (expected completion 2024).

4.2.2. The design of a Timely Delivery Incentive

Notwithstanding our view that a TDI is not necessary, Transgrid's view is that a TDI could not be effectively designed to promote efficient outcomes for consumers. This section sets out our views on the different design elements of a TDI that the AEMC would need to determine should it proceed with developing a TDI.

4.2.2.1. Scope of a TDI

Transgrid's view is that should the AEMC decide to provide a TDI, it should restrict the TDI to actionable ISP projects.

4.2.2.2. The benchmark dates

It is not clear how appropriate benchmark delivery dates can be calculated in a way that promotes efficient outcomes for consumers.

- For the benchmark dates to be credible, a view would need to be taken on realistic project delivery timeframes. The ISP currently identifies when new transmission infrastructure should be in place based on market modelling, it does not consider the practical ability of TNSPs to meet these timeframes. The benchmark dates would need to factor in the availability of skilled labour, appropriate community engagement, securing environmental approvals and completing the regulatory approval processes.
- A view would also be required on the nature of delays that are out of a TNSP's control and should be excluded from the TDI.
- The benchmark dates are also likely to be the subject of much debate which could distract from stakeholder's focus on delivering the required investment. If the benchmark dates are set too early, they could drive higher costs and sub optimal practices. If they are set too late, consumers may pay more than necessary.

4.2.2.3. The magnitude of the incentive

Transgrid does not support setting the magnitude of the TDI with refence to wholesale electricity prices as suggested by the AEMC. Given recent increases in wholesale electricity prices in the NEM, which have been due to events outside of a TNSP's control, linking the magnitude of the TDI to wholesale electricity prices would expose TNSPs and consumes to significantly higher costs for the ISP projects.

Should the AEMC decide to proceed with setting the magnitude of the TDI with reference to wholesale electricity prices, it should clearly set out its expectations on what the magnitude would be.

It is also our view that the magnitude of a TDI should be determined up front so TNSPs can take this information into account when making an investment decision on a project. We note it is not clear where this information to calculate the TDI would be derived currently – AEMO's ISP has a view on NEM wide net benefits and not individual projects.

4.2.2.4. Symmetrical or asymmetrical incentives

Our view is that a TDI should only be on a symmetrical basis if it is to be an incentive mechanism. An asymmetrical incentive would be a late delivery penalty mechanism. Transgrid does not support an asymmetrical incentive mechanism.

Transgrid is concerned that if the project dates in the ISP are used to set the benchmark dates in the TDI, this will result in an asymmetrical incentive mechanism by default. This is because the AEMO dates historically reflect the optimal delivery date – earlier delivery would result in inefficient outcomes for consumers.

4.2.2.5. Target investment decision, or subsequent delivery

Transgrid's view is that the focus of a TDI should be on the delivery of a project once an investment decision is made. If the TDI is applied to projects before an investment decision has been made, the TDI becomes a quasi-direction to proceed, which the AEMC considers not to be a proportionate response to the risk of a TNSP not investing. Transgrid agrees with the AEMC that the decision whether to invest in a project should remain with the TNSP.

4.2.2.6. Pass through arrangements

The AEMC is seeking views on whether there are any issues that might arise with a TNSP passing on the risk of a TDI to contractors. Transgrid's view is that TNSPs should be able to negotiate its commercial arrangements to ensure the right party is incentivised to manage the various risks This would result in an efficient outcome for consumers.

5. Managing cost risk uncertainty in the ex-ante framework

5.1. The AEMC's view

The AEMC's draft position is that recent developments under the ISP Rules framework, namely ex-ante risk allowances and the staged CPA process, allow TNSPs to appropriately manage risk and uncertainty around the costs of major projects, and that these processes should be given the opportunity to mature. However, the AEMC is seeking stakeholder feedback on specific areas of the regulatory framework that may warrant further consideration.

5.2. Our response

Transgrid supports the AEMC draft position that the actionable ISP process is a recent development and should be given the opportunity to mature.

While Transgrid's view is that there is good reason for the NER to exclude ISP projects from an ex-post review, if the NER does allow an ex-post review for the ISP projects, Transgrid supports the review being contained to each individual project as opposed to a TNSP's whole capital expenditure program for a regulatory period being reviewed. Consistent with the current ex-post review in the NER, the AER should only be able to exclude capital expenditure from a TNSP's regulatory asset base, where the capital expenditure incurred is above the capital expenditure allowance in the CPA for the ISP project. Further, the AER should only be able to reduce the amount of capital expenditure that goes into a TNSP's regulatory asset base up to the amount of any capital expenditure above the capital expenditure allowance for the ISP project. Any ex-post review framework in the NER should also be flexible to accommodate where a TNSP is to undertake multiple ISP projects as part of a single program of works. In this instance, it may be appropriate to recognise the program as a single ISP project for the purpose of the ex-post review.

Transgrid does not support additional stages to the CPA process:

- It would likely be implausible to stop work on a project at any stage beyond CPA1 given the amount of investment that would have occurred up to that point.
- Adding additional stages would create uncertainty and is likely to increase the time it takes to deliver a project, and the overall cost of a project.
- Adding additional stages would also dilute the efficiency incentives in the existing framework as indicated by the AEMC.