04 July 2024

Rex Greaves

Adviser
Australian Energy Market Commission
Level 15, 60 Castlereagh St

Sydney NSW 2000

Dear Mr Greaves,

Submission to the *Bringing early works forward to improve transmission planning* draft rule change

Thank you for the opportunity to make a submission on the Australian Energy Market Commission's ('**AEMC**') *Bringing early works forward to improve transmission planning* draft rule change.

The Clean Energy Finance Corporation ('**CEFC**') is a specialist investor with a deep sense of purpose; to invest as Australia's 'green bank' to help achieve our national goal of net zero emissions by 2050. The CEFC supports the development of a secure, reliable and affordable electricity system whilst lowering emissions through its investment activities. The Australian Government has allocated $19 billion to the CEFC under its Rewiring the Nation ('**RTN**') program to help spearhead the necessary transformation of Australia's electricity grid infrastructure.

The CEFC supports this proposed rule change that, amongst other things, allows Transmission Network Service Providers ('**TNSPs**') to submit an early works Contingent Project Application ('**CPA**') ahead of a Regulatory Investment Test for Transmission ('**RIT-T**') being completed. This will allow TNSPs to commence early works earlier and therefore promotes the timely delivery of critical transmission projects that will enable more renewable generation to connect and put downward pressure on electricity prices.

Market conditions for long lead equipment

The focus of our submission is on the long lead equipment subcomponent of early works, such as transformers, circuit breakers and synchronous condensers, and reservation of the manufacturing slots for such equipment. The CEFC is aware of the supply chain constraints facing TNSPs. There is unprecedented current and impending demand for long lead equipment globally which has meant that:

- Delivery timeframes have increased by anywhere from 50 per cent to several hundred per cent in some cases (e.g. high voltage transformer wait times have increased from 12 months to over three years from Tier 2 manufacturers, and over five years from Tier 1 European and US manufacturers in some cases).
- Cost increases of 30-50 per cent in the last few years are typical, but there are examples of costs increasing by more.

The existing regulatory framework does not adequately support the timely procurement of long lead equipment in the context of these market changes; regulatory funding approval is available too late in a project's approvals in order to achieve target operational dates in the Australian Energy Market Operator's ('**AEMO**') Integrated System Plan ('**ISP**') for actionable projects. This has driven the need for government intervention to secure long lead equipment and has increased the risk of delay to key transmission projects. As a result, the CEFC supports the intent of this rule change.

Mitigating additional risk on electricity consumers

In making this proposed rule change it is important to recognise there is a higher risk to consumers of them bearing the cost of procuring equipment that may ultimately not be utilised for the underlying project. This higher risk arises because:

1. Equipment is being procured at a time when less certainty exists as to whether a project will pass the RIT-T or feedback loop and proceed to development;
2. Without a RIT-T and selected route, there is less certainty that the correct type and volume of equipment is procured; and
3. Long lead equipment will be procured well ahead of TNSPs taking a final investment decision ("**FID**"), but because TNSPs have a right but not an obligation to take a positive FID, the project may not proceed. The rule proposes a definition for early works that allows for approval of regulatory expenditure for the procurement of long lead equipment (which is made clear by the AEMC's draft determination paper) during an early works CPA. While this is consistent with recent AER practice (for example, in the AER's assessment of VNI West early works in NSW), historically under the regulatory framework, major expenditure items—noting the cost of long lead equipment can be in the hundreds of millions of dollars with respect to ISP projects—is approved concurrently, or just prior, to a positive FID being made.

The AEMC has sought to mitigate these additional procurement risks to consumers via the inclusion of new factors in the rules that the AER must have regard to when assessing early works expenditure. Particularly, the AER would need to consider whether:[1]

> *"a) early works are common to all ISP candidate options and any other options that would be identified in a regulatory investment test for transmission for the actionable ISP project; and*
>
> *b) outcome of the early works activities can be sold or utilised to support other projects.''*

The CEFC considers these are relevant factors and supports their inclusion, and would appreciate the opportunity to input should they change between the AEMC's draft and final rule. However, CEFC also considers that on their own, these factors may not be sufficient to balance the increased risk to consumers that this proposed rule change creates. In particular, the CEFC has two concerns:

1) A TNSP may not sell equipment even if doing so is in the interests of consumers

To satisfy the proposed consideration in limb (b) of this rule, a TNSP would need to make representations to the AER that long lead equipment can be utilised in other projects or sold. It is highly possible that selling equipment or manufacturing slots would be in the best interests of consumers because the equipment could then be directed to the most important project proceeding at that time, irrespective of the TNSP delivering it. However, there are no

[1] AEMC, draft rule Clause 6A.8.2

requirements and limited (if any) regulatory incentives in place for the TNSP to sell the equipment in practice. This is because the expenditure for the equipment would have already been approved and cost recovery for the TNSP is assured.[2] Further, there are fair reasons a TNSP may choose to retain the equipment rather than sell it. For example, given the difficulty in acquiring such equipment in the current market, a TNSP may prefer to keep the equipment:

- As a spare to reduce its potential liabilities under the Service Target Performance Incentive Scheme;
- In case the TNSP has a future expansion need; and/or
- To earn a regulated return for the asset's life.

While such uses may be in the interest of the TNSP and have some benefit to consumers, these uses may not be in the best interest of the consumers that have, in effect, underwritten the equipment's acquisition.

2) Where the intended project does not proceed and equipment or manufacturing slots are either used by the TNSP for another project or sold, it may consequently generate an unfair advantage for that TNSP

The CEFC considers it important that long lead equipment, procured with the aid of consumer support and done so with heightened risk of not being utilised for the intended purpose, does not (intentionally or unintentionally) generate an unfair advantage to a TNSP.

Given the difficulty of procuring long lead equipment in the current market, holding long lead equipment could place a TNSP in an advantaged position for the delivery of other projects. For example, it may act as a discouragement for jurisdictions to deem a project contestable because holding the equipment may allow an incumbent TNSP to deliver the project faster. Holding the equipment may also provide an advantage to the TNSP or an unregulated affiliate in future contestable projects.[3] In the alternative where the equipment is sold, it is also important to consider the sale terms (i.e. at cost) given consumers, and not the TNSP, have borne the risk of the equipment's procurement.

The CEFC believes this issue to be a relevant consideration in this rule change. The CEFC acknowledges that in the absence of this proposed rule change, a TNSP could still acquire equipment which may provide it with an advantage, however, it would either be at their own risk and not backed by revenue approval, or be undertaken after there is a higher probability of the relevant project proceeding (a positive RIT-T and feedback loop being undertaken), which would be expected to be in the long term interest of consumers. However, the proposed rule change—which will address an inadequacy in the current framework and which we support—adds risk to consumers, and therefore, we consider this rule requires additional protections to go along side it to ensure the framework remains balanced.

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[2] The CEFC understands the AER would not be able to conduct an ex-post review of the equipment's expenditure per the '*overspending requirement*' in the rules and in the proposed *Managing ISP project uncertainty through targeted ex post reviews* draft rules, unless the project's costs exceeded the forecast overall.

[3] Selling equipment to affiliates at market rates may not breach ring fencing, but could still provide a competitive advantage by virtue of the affiliate being able to deliver a contestable project sooner than its competitors.

Strengthening consumer protections

The CEFC does not have a preferred mechanism to address the concern outlined in this submission. As a principle, the CEFC considers it important that under any such mechanism:

- Consumers receive the benefit of long lead equipment that they have underwritten under this proposed rule; and
- TNSPs do not face a financial penalty if the equipment they have procured cannot be used for the originally intended purpose; otherwise they would be discouraged from accessing this proposed rule and procuring long lead equipment earlier.

While potentially difficult to implement, an option that could meet this principle is to require TNSPs to transfer long lead equipment or manufacturing slot rights to the relevant jurisdictional planning body at cost price in the circumstance that the equipment:

- Is not used for its original intent; and
- The jurisdictional planning body considered the equipment could be best used in a project not being conducted by the original TNSP.

The jurisdictional planning body would then have an opportunity to on-sell the equipment to another proponent. We recognise this would not be a simple process and we would welcome the opportunity to discuss this with the AEMC and stakeholders.

We value the opportunity to provide input into this process and look forward to the opportunity to engage further with the AEMC. Should you wish to discuss this submission further, please contact Frans Jungerth, Associate Director - RTN, frans.jungerth@cefc.com.au.

Sincerely,

Ian Learmonth
Chief Executive Officer