

Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

8 November 2019

By electronic submission

**Re: Coordination of generation and transmission infrastructure proposed access model and renewable energy zones discussion papers**

Spark Infrastructure welcomes the opportunity to provide further feedback to the AEMC's coordination of generation and transmission investment (**COGATI**) review in response to the discussion papers on the proposed access model and renewable energy zones (**REZs**).

Spark Infrastructure is a provider of long-term equity capital into energy infrastructure investments in the National Electricity Market (**NEM**) including TransGrid, the electricity transmission network in NSW and the Bomen Solar Farm (under construction) in NSW. Therefore, we have experience with the challenges and opportunities associated with transmission network investment and renewable generation.

The discussion papers outline that the proposed access model aims to improve the efficiency of generator location and dispatch decisions by introducing locational marginal pricing (**LMP**) and improve certainty for prospective generators through the availability of a financial transmission right (**FTR**). The AEMC expects these reforms to lower electricity prices to customers as costs associated with congestion and disorderly bidding are reduced and certainty associated with the current annual reset of marginal loss factors (**MLFs**) and the financial impact of curtailment and other generator decisions are improved.

The AEMC is also proposing to address the free-rider problem in REZs by introducing a long-term hedge for generators that pay for shared transmission assets to improve the likelihood that several new generators will share the costs of connecting to the transmission system.

We broadly support the principles behind the proposed reforms. However, we are skeptical that the benefits will warrant the additional complexity. We consider that further testing is required to demonstrate that:

- The signals to improve the efficient locational decisions are greater than the signals that currently exist in the MLF scheme and risk of curtailment;
- That the dispatch will be more efficient than the current arrangements and not just result in an alternative floor being established;
- The FTRs will provide certainty and value over and above that currently available through commercial contracts; and
- That the cost of establishing and purchasing FTRs will be offset by reductions in costs elsewhere.

We also support further reforms to the regulatory investment test for transmission (**RIT-T**) to ensure it is fit for purpose in facilitating timely and efficient investment in the interconnectors and REZ's that AEMO identified will deliver significant savings to customers if the Integrated System Plan (**ISP**) is actioned.

However, we have seen unprecedented levels of change and government intervention in the electricity sector which has created considerable uncertainty for investment. As acknowledged by the Grattan Institute, knee-jerk reactions have created uncertainty and discouraged the very investment that is

needed.<sup>1</sup> Therefore, any additional changes must be clearly shown to provide net benefits to consumers in relation to price, reliability and security of supply as required under the National Electricity Objective (NEO).

Contributing to the poor investment environment is the poor returns available to investors in regulated transmission networks. Under current market conditions, the equity returns set by the rate of return instrument (RORI) are less than 5 percent<sup>2</sup> – a fall of 1.38 per cent since the RORI was released in December 2018. These equity returns are internationally uncompetitive and will have an impact on funds available for timely investment in new transmission network capacity.

We recommend that a common agreed framework that provides an objective and transparent assessment of the long-term impacts on consumers in relation to price, reliability and system security be developed and applied. This will improve the co-ordination and rigor of the recommendations and decisions being made by the AEMC, AEMO and the AER that will affect the incentives for investment.

This assessment should include consideration of financeability which directly affects the ability to attract capital and the cost of capital for generators and network businesses. If the investment environment remains uncertain, subject to unpredictable change and poor returns, neither generators nor network businesses will seek to fund additional transmission network investment.

In the absence of private investment, taxpayers will continue to underwrite future investment in the electricity system which will in turn crowd out private investment.<sup>3</sup> This should not be necessary, is not desirable and is not sustainable.

The remainder of this submission comments on the proposed reforms outlined in the discussion papers.

### **1. Locational marginal pricing should deliver greater efficiency benefits than current arrangements to warrant the additional complexity**

We support the principle that locational marginal pricing has the potential to improve the signals to prospective generators to locate in efficient locations and improve the efficiency of dispatch. However, the proposal introduces considerable additional complexity that may not outweigh benefits. There are already strong locational signals to prospective generators in MLFs and the risk of curtailment, which would only be absorbed in the LMP and not enhanced. Further, the marginal cost for renewable generation is approaching zero, so it cannot be assumed that dispatch will be more efficient.

### **2. Further work is needed to ensure FTRs are effective**

The effectiveness of the FTRs will be affected by the design of the product and market. Some key design issues include:

- Eligibility – the proposal includes a requirement for purchasers of FTRs to be a physical participant. However, this is not required for purchase in the secondary FTR market. It is not clear why only physical market participants should be able to purchase FTRs or how a physical market participant is to be defined. The eligibility to purchase FTRs should reflect identified concerns in the electricity market and not inadvertently prevent legitimate additional participants from purchasing FTRs simply because they are not currently participating in the market.
- Timing – the proposal is for FTRs is that there will be a staggered release and cover quarterly periods up to three years in advance. Limitations on the release and duration of FTRs will decrease the effectiveness and value of the FTRs as a risk management tool. We recommend

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<sup>1</sup> Grattan Institute, Power Play, How governments can better direct Australia's electricity markets, October 2019, p. 6.

<sup>2</sup> AER, SA Power Networks Distribution Determination 2020 to 2025 Overview, October 2019, p. 27.

<sup>3</sup> Grattan Institute, Power Play, How governments can better direct Australia's electricity markets, October 2019, p. 3.

further work and consideration of practical case studies to assess and meet the needs of existing and prospective generators in relation to certainty.

- Specification – if the payout under an FTR is to be scaled where there are insufficient funds, the formula and time period over which a shortfall is identified must be specified so that prospective generators can predict the likelihood and extent to which payments could be reduced over time in assessing the value of the FTR.

We also encourage further detailed assessment of the AEMCs assumptions regarding the costs of congestion, losses, capital and the scheme itself to ensure that the fall in costs is likely to be greater than the increase.

### **3. Grandfathering FTRs will be critical to the success of the reforms**

The proposal to allocate FTRs based on existing capacity, scaled over time and tradeable will assist an efficient and effective transition by providing an opportunity for existing generators to better understand the scheme and manage impacts of the reforms. Grandfathered FTRs should be issued well in advance of the commencement of the scheme to prevent distortions in the interim period.

### **4. Financial transmission hedges will not address the uncertainty of the RIT-T process**

We accept that accompanying a contribution to a shared transmission asset with a long-term hedge might increase the likelihood that prospective generators will agree to share the costs. However, these hedges are unlikely to outweigh the uncertainty inherent in the RIT-T process about the likelihood, timing and cost of the investment.

An inherent uncertainty in the RIT-T process is that consumers remain concerned that more transmission capacity will be built than necessary and that they will pay more as a result. However, additional transmission investment in interconnectors and to connect renewable energy zones can reduce the total cost to consumers. Therefore, an assessment of the long-term impacts on price, reliability and system security of providing more new transmission capacity than utilised in the short term with an alternative scenario where no new transmission capacity is provided should be included in the RIT-T process. This analysis will highlight the importance of focusing on total system costs rather than transmission costs which represent less than 10 per cent of a customer's bill.

### **5. The reforms must deliver net benefits to consumers**

The AEMC has committed to modelling the costs and benefit of the proposed reforms. This work is critical to ensure proposed reforms achieve the NEO and do not result in additional complexity and costs being imposed on the system and consumers. We would like to understand the incremental value of each of the proposed reforms – LMP, FTRs and long-term hedges for shared transmission connection assets – before they are implemented.

Please contact me on 0421 057 821 for further discussion regarding this submission.

Yours sincerely,



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