

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

5 August 2019

Project Reference: EPR0073

By electronic submission

Re: Submission to the Coordination of Generation and Transmission Investment – Access Reform Directions Paper

Spark Infrastructure has previously provided submissions to the Australian Energy Market Commission's (**AEMC's**) consultation regarding coordination of generation and transmission investment (**COGATI**) in relation to access and charging and is pleased to participate in this next phase of the review by responding to the Directions Paper.

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. The NSW transmission network is critical to delivering the Australian Energy Market Operator's (**AEMO's**) Integrated System Plan (**ISP**) and ensuring the lowest cost of electricity is delivered to consumers in the NEM and that the transition to renewable generation to meet climate policy targets is delivered efficiently (i.e. at least cost).

The Directions Paper indicates that the introduction of dynamic regional pricing and transmission hedges will:

- Inform planning and investment decisions for transmission networks so that transmission investment is efficient in reducing the costs to end users; and
- Provide cost and revenue certainty for generators reducing barriers to investment and ensuring generators locate in the most efficient places within the time horizon required and reducing the contribution of congestion to higher prices.

As outlined in our previous submission, we support pricing reform and the use of better information to improve the efficiency of plans and investment decisions. However, we have concerns that the transmission hedge scheme will not deliver the investment required to support financial firm access to transmission capacity or reduce the total costs to customers.

The design features such as grandfathering arrangements, obligations on purchasers, and the specification of the product (availability, duration and pricing) will likely impact on incentives for investment, costs and benefits and so will need to be specified in further assessments. However, it is difficult to comment on these details when there are concerns at a high level that the scheme will not achieve what is intended. Subject to this scheme going forward, it will be critical to map out the decisions required, the information available and the incentive to progress at each stage of the process to confirm that the proposal will work in practice.

The next phase of the review should provide further detail and present the findings and net impact of:

- The increase in costs to generators to achieve greater certainty compared to the current arrangements.
- The additional costs to be incurred by Transmission Network Service Providers (**TNSPs**) to build capability to design and administer a financial hedge scheme.
- The increased risk associated with recovering the cost of new investment and the impact on the incentive for TNSPs to undertake the new investment.
- The effectiveness of transmission hedge products to remove the first mover disadvantage if they must also fund, and provide an incentive for, transmission investment.

The transmission hedge scheme is likely to increase the total system costs to customers

In our view, a transmission hedge scheme will impose the following additional costs which will likely to increase costs to customers:

- Additional costs to the TNSP to establish and administer the transmission hedge scheme as well as financially and operationally ring-fence the services underwritten by the scheme from regulated transmission use of system (**TUOS**) charges. These costs will need to be recovered through regulated TUOS charges.
- Additional costs to the generator to purchase transmission hedges for the location and period over which it chooses revenue certainty. Generators will seek to recover these costs through higher wholesale energy prices.
- Compensation for the increased risk of recovering the cost of investment. If the additional risk is not compensated, there will be an impact on the level of investment.

The transmission hedge scheme may frustrate planning and investment decision processes

A TNSP will remain required to undertake a regulatory investment test (**RIT-T**) for new transmission capacity investment to underwrite the transmission hedges. However, the information available to support the RIT-T will be limited to information on existing and forecast transmission hedges. Further, the RIT-T process is a lengthy process and creates considerable uncertainty about the cost and timing of new capacity. The current RIT-T for EnergyConnect (the proposed new transmission interconnector between NSW and SA) is demonstrating that the RIT-T process is not fit for purpose for major expansions, and hence an additional reliance on the RIT-T without it first being re-examined is likely to be ill-fated. Therefore, this scheme may not provide generators with enough certainty to enter in to, or reveal demand for, transmission hedges.

In addition, the price of a transmission hedge will need to be enough to provide an incentive to undertake required investment and may not resolve the first-mover disadvantage where there is insufficient demand for the capacity subject to a transmission hedge. Further, generators and TNSPs will need to understand how the scheme will work and the cost of the scheme to have confidence to use it.

We consider that the ISP and work by the Energy Security Board (**ESB**) to make the ISP actionable will make a significant contribution to improving the investment environment for TNSPs and new generation and must form the basis for an assessment of incremental benefit of the reforms. The ISP outlines a plan for the system that delivers the greatest benefits to customers given the identified constraints and investment options. The proposed transmission hedges scheme may be a costly and complex solution that reduces the reliability of future information and forecasts required for planning processes, continues to require the application of the RIT-T without resolving its problems, and provides no additional benefit when compared to the ISP and ESB processes.

In Summary

We question the need for a transmission hedge scheme without further examination. The scheme appears to be an elaborate and complex scheme in an already complex energy market which if poorly constructed and implemented will lead to increased costs (which end consumers will bear) and stymie much needed efficient and timely investment in the supporting transmission grid.

We also question how practically major regulated network expansions and decisions (i.e. expansions to be used publicly, and not privately) can be effectively paid for by market participants (through the hedge scheme) and yet the assets remain open and available for 'public' use.

A cost benefit analysis of options and mapping of the planning and investment decision process is required to ensure that the proposed reforms will work and not just increase costs to customers. This analysis is likely to require more time than allowed for under the current timetable and so we recommend extending the timeframe for finalising recommendations on these important reforms, if they are in fact needed. Further, allowing more time will enable the information and findings of the 2020 ISP and the ESB refinements of regulatory processes to be included in the assessment.

Investors are critical stakeholders in this review, and we welcome the invitation to participate in the technical working group and look forward to further opportunities to test and contribute to the outcomes.

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

Yours sincerely,

A handwritten signature in blue ink, appearing to read "S McMahon".

Sally McMahon
Head of Economic Regulation
Spark Infrastructure