

8 September 2020

Energy Security Board

By email: info@esb.org.au

Re: Response to Consultation Paper on Renewable Energy Zones Planning

Spark Infrastructure is pleased to provide this submission to the ESB's Consultation paper on Renewable Energy Zones (REZ) Planning. We have interests in some \$18 billion of electricity network assets in NSW, Victoria and South Australia delivering energy to more than 5 million customers across the National Electricity Market (NEM). This includes 15% interest in TransGrid, the transmission network service provider (TNSP) in NSW and 100% ownership of the Bomen Solar Farm in Wagga Wagga, NSW.

We are strongly committed to the energy transition, whether that be through renewable generation and storage, or through building new networks required to deliver energy security and reliability, support proposed generation connections, unlock renewable energy resources, and reduce total system costs to customers.

AEMO's 2020 Integrated System Plan (ISP), identifies nationally significant and essential investments in the electricity system that will deliver \$11 billion in net benefits. Under the optimal development path in the ISP there are over 18 projects to augment the transmission grid and support REZs which represent direct investment opportunities for TransGrid in NSW with a combined capital cost of approximately \$13 billion and \$7.5 billion before 2028.¹ In addition to the significant investment required by TransGrid and the successful development of Bomen Solar Farm, we are actively exploring opportunities in solar, wind and storage, including those opportunities that may be revealed as the framework for planning and supporting REZs is developed. We therefore have a significant interest in getting the regulatory settings for investment right.

We support the recommendations to establish an integrated planning framework to support REZ development. We understand that the framework will provide for AEMO to identify REZs in the ISP enabling them to benefit from the Actionable ISP Rules, and, in conjunction with a jurisdictional planning body, this should facilitate planning and regulatory approval processes. We expect that this will improve the likelihood that REZs will be developed and a centralised approach will assist in uncovering relevant information to improve the efficiency of power system design, navigate uncertainty and co-ordinate various stages of generator commitment.

However, we do not support the recommendation for REZ design activities to be included in operating expenditure allowances or in a cost pass through application for TNSPs. This approach would penalise TNSPs by as much as \$40 million per year² for incurring costs required to properly inform, consult, and prepare REZ design reports even if the costs are efficient or incurred by a Jurisdictional Planning Body (JPB) that is not the TNSP. These costs will be both difficult to forecast and manage without compromising the output (and not able to be managed at all where the TNSP is not the JPB), and the strong incentive to minimise these costs could undermine an otherwise effective planning framework.

We recommend that these costs are passed through in annual variations to transmission prices in a similar manner (and process) as that which applies to transmission planner costs incurred by AEMO.

¹ AEMO, Integrated System Plan, July 2020, modelled cost estimates, p. 89.

² Approximate materiality threshold for cost pass through application for TransGrid. Similar penalties also occur where costs incurred are greater than operating expenditure allowances.

We note that significant issues are still to be resolved regarding access, regulation, cost and pricing arrangements which will need to be taken in to account in the planning framework. For example, it remains unclear whether the JPB will also determine which assets will be regulated or contestable and whether shared user assets and connection assets will be subject to an access regime or provide for firm rights to capacity. We encourage the ESB to enable the planning framework to evolve with the policy framework being developed in Stage 2 of this review.

We also recommend further consideration of specific arrangements for Actionable ISP Projects to mitigate unintended revenue and risk challenges under the current regulatory framework.

A challenge that faces all new investment under the regulatory framework is the current low return environment. Under the current regulated return methodology that applies to regulated networks, movements in bond rates and errors in forecasting inflation are passed directly through to equity investors. The current COVID-19 economic crisis is delivering anomalously low bond rates (including as a result of direct and unprecedented intervention by the Reserve Bank of Australia) and inflation. If these conditions continue and are not appropriately addressed in AER instruments, models and decisions, equity returns to investors will be unsustainably low and remain globally uncompetitive.³ This will have implications for incentives for investment and impact the interests of consumers over the long term.

The impact of these low returns is further exacerbated for significantly large projects because the regulatory framework defers the recovery of depreciation revenue putting pressure on credit metrics, and includes risks and penalties when expenditure is higher than the allowance even if the expenditure is efficient. We also note that there is no opportunity for these decisions to be tested by stakeholders.⁴

To ensure that the returns available for regulated network infrastructure are sufficient to attract capital and commensurate with risk, consideration might be given to enabling variations to regulated returns, flexibility in revenue profile over the life of investment and mitigating cost recovery risk and penalties on efficient investment for ISP projects, particularly where that investment is proportionately large compared with ongoing expenditure programs. These decisions should also be subject to review in a draft decision or third party review process.

I would be happy to discuss these matters further and can be contacted on 0421057821.

Yours sincerely,



Sally McMahon
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³ The Brattle Group found that the AER's return on equity for the recent determinations (June 2020) were lower than 7 other regulators in the UK, US, New Zealand, Netherlands, and Italy. See The Brattle Group, A review of international approaches to regulated rate of return prepared for the Australian Energy Regulator, June 2020, p. 49.

⁴ There is no draft decision required in a contingent project application process or external review of AER revenue, expenditure or return decisions.