

10 July 2020

Ms Clare Savage
Chair
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001BY

By Email: Clare.Savage@aer.gov.au

Cc: Mark.Feather@aer.gov.au

FROM THE OFFICE OF THE
CHIEF EXECUTIVE OFFICER

Level 22
530 Collins Street
Melbourne VIC 3000

Postal Address:
GPO Box 2008
Melbourne VIC 3001

T 1300 858724
F 03 9609 8010

Dear Ms Savage,

AER Cost Benefit Analysis Guidelines and Integrated System Planning

AEMO offers the following comments to the AER Cost Benefit Analysis Guidelines. Specifically, we request that the finalisation of the Draft Cost Benefit Analysis (CBA) Guidelines (draft guidelines) be postponed, to allow the opportunity to consider AEMO's practical insights on using the guidelines, arising from the experience of producing the 2020 ISP.

Transitional arrangements deem the 2020 ISP to be compliant with the new ISP Rules and the final CBA guidelines will not apply to the 2020 ISP. Despite this, AEMO is endeavouring to align its 2020 ISP with the newly commenced ISP Rules and the AER's consultation draft guidelines wherever possible. This approach serves the interests of transparency and enables a smooth transition towards the formal requirements for the 2022 ISP. However, if the Guidelines are finalised without addressing AEMO's concerns, significant difficulties will persist for the development of the 2022 ISP process.

Our work is highlighting that important elements of the draft guidelines are proving difficult to apply and are creating analytical restraints which undermine efficient and timely scenario analysis and system planning, and in doing so, appear to risk the status of the ISP as an actionable system plan.

In addition, because the final CBA guidelines may apply to some RIT-Ts for actionable ISP projects identified in the 2020 ISP, it is critical that we achieve alignment between this first ISP under the Rules and the RIT-T.

AEMO concerns with application of the Draft CBA Guidelines

The intention reflected in the ISP Rules was for the draft (and final) guidelines to be developed recognising the risks to consumers from uncertainty and providing AEMO with the necessary flexibility to manage this. The Rules expressly indicate the need to give flexibility to AEMO in its approach to scenario development, modelling and selection of the optimal development path,

and have regard to the need for alignment between the ISP and the RIT-T as it applies to actionable ISP projects.

We are concerned that the draft guidelines introduce analytical limits on AEMO's flexibility – for example by not allowing AEMO to treat discrete market risks such as early closures of plant, or delays in development as potential events against which option values (and risk tolerances) may be assessed, the draft guidelines essentially require these events to be modelled as separate scenarios, requiring such a plethora of individual scenarios as to undermine the value of scenario analysis.

Ideally, these events can be used to assess option value and risks to help in selecting one development path over another, but need not be tested in every scenario. Flexibility is further restricted by requiring that all development paths should remain fixed across scenarios, essentially forcing non-anticipatory approaches. In reality, decisions around future investments need not be made now, and should be able to vary in different futures.

To work around these restrictions in the current ISP, AEMO has had to introduce additional scenarios that represent variants on the Central scenario to test the impact of discrete market events. AEMO is concerned that the current CBA guidelines would restrict RIT-T proponents from considering these important risks as part of their RIT-T CBA maximisation. In future, even this will not be possible if the draft Guidelines are adopted unless this plethora of derivative 'scenarios' have been consulted on at the very beginning of the ISP process and included in the Inputs, Assumptions and Scenarios Report (IASR). Further, the challenging task of assigning relative likelihoods to every scenario becomes even more difficult when you have a large number of only slightly different scenarios to consider.

To demonstrate the value of flexibility in the ISP optimal development path, AEMO has had to artificially introduce early works as the first stage of projects that may proceed under some but not all future scenarios. This sub-optimal work-around has the potential to contribute to a large number of very similar development paths, with and without combinations of early works, that then need to be tested across all scenarios and sensitivities. This again leads to a much larger number of simulations to be performed in order to create the requirement of CBA matrix, with minimal incremental value.

AEMO's preference would be to recommend a single development path that is dynamic in nature and therefore varies depending on the future that unfolds. Decisions that need to be made now should be common to all scenarios as the decision is made without the benefit of future information, but decisions that do not need to be made until later should be allowed to vary across scenarios. This approach also seems to better align with the expressed intention of Energy Ministers regarding the ISP.

Risk of ISP/RIT-T misalignment

The stated intent of the ISP Rules was for the AER CBA Guidelines to have regard to the need for alignment between the ISP and the RIT-T as it applies to actionable ISP projects. As such, an area of great concern for AEMO is our need to address significant risks in the ISP, such as the loss of major power units due to premature retirement and insufficient market response.

If the ISP identifies that a transmission solution is the best way to address these risks, it is crucial that requirements for the ISP and RIT-T as set out in the CBA guidelines are aligned and allow

RIT-Ts to satisfy regulatory requirements. The collective effort of stakeholders and AEMO in developing the ISP are ultimately undermined if an investment proposed in the ISP faces difficulties in satisfying RIT-T requirements, even where ISP and RIT-T inputs and assumptions are consistent. This outcome would also be inconsistent with the expressed policy intention of Energy Ministers and Governments to provide for an actionable national system plan that achieves the necessary transmission build.

In addition to concerns about the workability of the draft CBA guidelines in developing the 2020 ISP, AEMO also has some broader concerns on substantive positions adopted for other matters covered in the guidelines. For example, the requirement that funds moving between 'Participants' are to be treated as a wealth transfer that cannot affect the calculation of costs or market benefits under the ISP. I note this issue received consideration as part of prior consultations, but I believe further discussion is required by the market bodies to ensure that consumer interests in affordable energy remain paramount in all we do as we reinvest in the system.

While there have been constructive discussions between our teams prior to the publication of the draft guidelines and more recently, I believe that this issue is sufficiently important to warrant a postponement to finalising the draft guidelines to achieve a better regulatory environment for the 2022 ISP.

If you would like to discuss these issues further with AEMO, please contact myself, or Kevin Ly, Group Manager - Regulation, kevin.ly@aemo.com.au. Thank you for considering this request.

Yours sincerely



Audrey Zibelman
Managing Director and Chief Executive Officer