Mr Sebastian Roberts
General Manager
Australian Energy Regulator

By email: contingentprojects@aer.gov.au

30 October 2020

Dear Mr Roberts,

TransGrid and ElectraNet – Project EnergyConnect contingent project

ENGIE Australia & New Zealand (ENGIE) appreciates the opportunity to respond to the Australian Energy Regulator (the AER) regarding the contingent project applications (CPAs) by TransGrid and ElectraNet (the proponents) in respect of Project EnergyConnect (the Project).

The ENGIE Group is a global energy operator in the businesses of electricity, natural gas and energy services. In Australia, ENGIE has interests in generation, renewable energy development, and energy services. ENGIE also owns Simply Energy which provides electricity and gas to more than 720,000 retail customer accounts across Victoria, South Australia, New South Wales, Queensland, and Western Australia.

Rising costs are a concern for consumer bills

ENGIE is dismayed to observe the sharp rise in costs of the Project. Only 9 months ago, in January 2020, the AER signed off on a Regulatory Investment Test (RIT-T) application from the Project's proponents based on a total cost of $1,530m. Now, the two proponents are between them seeking $2,382m, a 56 per cent increase[1]. While the costs for transmission lines and substations have increased from $1,240m to $1,682m the "other costs" category has increased from $290m to $1,079m, a quite extraordinary 272 per cent increase.

ENGIE recognises that the direct capital expenditure estimates have been market tested, but this only covers a minority of the "other costs". Accordingly, ENGIE urges the AER to do whatever it can within its powers to impose appropriate cost discipline on the proponents and ensure only efficient costs are allowed. Further, it would be useful for the AER to seek clear explanations from the proponents of how they so badly underestimated costs at

[1] It may even be a higher per centage increase, as it appears that the RIT-T figure is expressed in $2018/19 while the CPAs are in $2017/18

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the RIT-T stage. This would assist in ensuring better cost estimates for the next round of ISP projects and would be in the best interests of customers.

Frankly, it is difficult for other stakeholders to evaluate if the Project's costs appear efficient or why these costs have increased so much in such a short time. It does not assist that the two Proponents appear to have used different category descriptors and that these do not clearly match across to the high level category descriptors in the RIT-T, nor that the two sets of cost estimates appear to use a different year's dollar base.

While relatively small elements of the overall costs, ENGIE is especially interested to understand the appropriateness of TransGrid's claim for "biodiversity risk costs" and ElectraNet's for "project risk". The two businesses will get a risk-adjusted return on capital for these additions to their RAB. Their risk exposure is also mitigated by the Capital Expenditure Sharing Scheme (CESS) which requires consumers to pay for a proportion of any overspend.

TransGrid's claim for "real input escalators" also requires closer scrutiny, especially when ElectraNet does not appear to have sought similar.

The broader context

The need for the AER to impose cost management discipline on the Proponents is made still more important by their apparent attempts to use this and other major projects as a reason for seeking a range of fundamental changes to the regulatory framework. These include:

- Both proponents' applications for derogations to standard practices with respect to RAB indexation and depreciation[2].
- TransGrid's submission to the AER's Inflation Review, which "focuses on the impact of the AER's approach to regulatory inflation on our investments in Major Projects" and sought changes to the inflation methodology on that basis[3].
- This submission also pointedly referenced the "current record low return on equity"[4], perhaps signalling that TransGrid will also use its large capex program to push the AER for a higher rate of return in the 2022 Rate of Return Instrument Review.
- TransGrid's Contingent project application indicates they are also seeking a derogation from the application of the CESS in order to protect them even further from cost overruns (section 5.1.4, Appendix B)[5].

The Proponents' estimates of the impact of their expenditure on customer bills needs to be considered in this context. These estimates would have assumed the current regulatory framework applies. However, the combined

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[2] Participant derogation – financeability of ISP projects (TransGrid) and Participant derogation – financeability of ISP projects (Electranet), both available at https://www.aemc.gov.au/our-work/changing-energy-rules/rule-changes

[3] Response to 2020 Inflation Review – Discussion Paper

[4] Op. cit.

[5] TransGrid – Project Energy Connect – Principal application,

impact of the changes to the framework being sought would materially increase and bring forward the amount's consumers are obliged to pay for the Project.

Net benefits may be overstated

ENGIE understands that the AER has confirmed it is acceptable for the Proponents to present a benefits case that has been revised upwards so that it still exceeds the revised cost, on the basis that the modelled benefits use more recent assumptions in line with the 2020 ISP[6]. Nonetheless, it is notable that the latest costs appear to exceed the value of the net benefits as determined by the AER in its RIT-T decision (although the way costs and benefits are presented in RIT-Ts does not facilitate this comparison).

The proponents have also claimed additional benefits, that at least implicitly they would like taken into account. For example, TransGrid submitted a report from FTI Consulting that assessed so-called "wider benefits"[7]. The title does give rise to concern of bias inherent in such an assessment. ENGIE considers that there are also wider costs and risks that may not be taken into account by the RIT-T process, and these should equally be considered in any holistic consideration of the Project.

The fundamental driver of the market benefits that the Project is purported to deliver is fuel cost savings, primarily from NSW coal displacing SA gas generation, to the extent that the modelling indicates that three SA gas plants would close within a year of the interconnector beginning operation. Aside from the additional greenhouse emissions this fuel switching may cause, ENGIE sees some key risks that have not been fully assessed.

There will be a lack of dispatchable capacity located in South Australia from which load (retailers and large users) can buy hedge contracts. Local renewables are unlikely to be in a position to offer caps or swaps and inter-regional hedging may not be appropriate for the needs of load. This risk is rendered more acute by the requirements of the Retailer Reliability Obligation. It is not clear how this will resolve, but any plausible scenario seem likely to push up consumer costs in ways that are not captured by the market modelling.

The lack of dispatchable synchronous capacity also puts an even heaver reliance on inter-regional resources to ensure reliability and security in the South Australian region. While a new interconnector will materially reduce the risk of South Australia islanding, it cannot and does not purport to eliminate this risk. Thus, while the risks of islanding are invariably lower, the consequences are likely more severe. These consequences could be mitigated by further investment in standalone providers of system strength, inertia and reliable capacity, but such costs would then in turn undermine the Project's net benefits and have not been fully considered.

ENGIE recognises that the AER may not have the capacity to take these matters into account in deciding to grant the revenue allowances to the Proponents. Nonetheless, it is indicative of the need for a more thorough approach to considering all the costs and benefits than the Proponents have shown to date.

[6] AER Letter to ElectraNet Re: Request for assurance on updated cost benefit analysis for PEC
[7] FTI consulting, Assessing the Benefits of Interconnectors

Should you have any queries in relation to this submission please do not hesitate to contact me on [redacted]

Yours sincerely,

Jamie Lowe
Head of Regulation,
Compliance and Sustainability