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Australian Energy Regulator
GPO Box 520
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Submitted via ISPguidelines@aer.gov.au

RE: Issues Paper – Guidelines to make the Integrated System Plan (ISP) actionable

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Australian Energy Regulator's (AER) Issues Paper on the guidelines to make the ISP actionable, which seek to develop binding ISP guidelines to support changes to the National Electricity Rules (NER) to convert the ISP into an actionable strategic plan.

About ERM Power

ERM Power (ERM) is a subsidiary of Shell Energy Australia Pty Ltd (Shell Energy). ERM is one of Australia's leading commercial and industrial electricity retailers, providing large businesses with end to end energy management, from electricity retailing to integrated solutions that improve energy productivity. Market-leading customer satisfaction has fuelled ERM Power's growth, and today the Company is the second largest electricity provider to commercial businesses and industrials in Australia by load[1]. ERM also operates 662 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland, supporting the industry's transition to renewables.

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General comments

The AER provides an essential role in ensuring and maintaining integrity in the regulated transmission investment process. This role has evolved with the shifting market dynamics of the National Electricity Market (NEM), particularly with the development of the ISP as an actionable system plan for the power system. However, the AER continue to be responsible for identifying best practice cost benefit analysis (CBA) and forecasting to protect consumers and promote investment efficiency. Although the function has expanded to make the ISP actionable, the role of the AER will continue to provide rigorous and comprehensive regulatory oversight of the application of the ISP through the development of guidelines and review processes.

The objective of the ISP guidelines is to establish a framework to apply to the proposed revision of the regulatory investment test for transmission (RIT-T) process to provide certainty, transparency and accountability for AEMO, RIT–T proponents and stakeholders. ERM Power fully supports the AER's role in achieving the objectives of the ISP guidelines in consultation with stakeholders. We provide the following recommendations to assist the AER to achieve the objectives of the ISP guidelines:

- The integrity of the current RIT-T governance and consultation arrangements should be maintained

[1] Based on ERM Power analysis of latest published information.

- AEMO should be provided a prescriptive approach to selection of optimal ISP development paths to promote transparency
- The guidelines should provide additional guidance on the appropriate selection of optimal ISP development paths
- An alternative approach to benefit modelling would provide a comparative basis of ISP project costs with greater accuracy
- The identified need of investment assessment processes should be clearly linked to the consumer benefit in the guidelines
- A dispute resolution mechanism should be accessible at all stages of the ISP development and subsequent RIT-T process

We provide further information on these points below.

Governance and consultation

The RIT-T provides an essential test of regulated transmission proposals to ensure that costs allocated to consumers from network and non-network investments are warranted. The AER's governance of the current RIT-T process provides required oversight of the application of the RIT-T through CBA determinations. Due to the intention of the proposed ISP framework to impact transmission planning by triggering RIT-Ts and replacing some elements of the RIT-T process, the framework should rightly be subject to additional governance arrangements through the CBA and forecasting best practice guidelines. Similarly, the significance of the intended changes to the RIT-T framework from a consumers perspective means that it is important to maintain an appropriate level of oversight from the AER. We believe that the proposed ISP and subsequent RIT-T process must be subject to the same rigor of AER review as applied to the current RIT-T process.

The AER proposes to adapt the current RIT-T application guideline to the ISP process, which will undertake CBAs of the ISP development paths identified by AEMO, rather than assessing individual ISP projects. ISP development paths represent planning scenarios of significant complexity and require modelling of higher numbers of inputs and assumptions than individual projects. It is currently proposed for AEMO to develop potential network options in consultation with TNSPs. However, due to the complexity of the development path scenarios, it is essential that AEMO develops potential network development options in consultation with a broad range of stakeholders.

We encourage the inclusion of broader stakeholder consultation requirements within the AER's ISP guidelines. It is imperative that stakeholders have the ability to provide input into the selection of network development options in the early stages of AEMO's development of the ISP, and that this be subject to a rigorous consultation process. The ISP Best Practice Forecasting Guideline must include requirements for extensive consultation in the development of potential ISP projects at the initial development stage. AEMO should be required to consider all reasonable network development projects proposed by stakeholders during the consultation process and provide reasons for not providing support to progress a project to the ISP project assessment phase.

Prescription versus flexibility

The proposed ISP framework represents system planning reform of significant scale. As a system plan seeking to achieve the delivery of power system needs over a 20-year planning horizon, the inputs, modelling assumptions and planning scenarios selected for inclusion will drive long-term asset investment in the NEM. As the market operator and system planner, AEMO will play a significant role in the development of the future market through their selected modelling approaches.

Considering the direct impact of the state of the market on consumers, it is important to achieve appropriate regulation of planning and modelling approaches which shape the future market. In the proposed guidelines, the AER present the initial view to allow AEMO increased flexibility in their selection of optimal development paths. Although the AER supports this view with a corresponding requirement for transparency, ERM Power is concerned that the Issues Paper does not provide adequate clarity on what specific measures are required to promote transparency for areas in which AEMO is able to exercise discretion. In absence of the inclusion of broader stakeholder consultation requirements within the guidelines, ERM Power are unable to assess whether the proposed framework provides sufficient certainty and transparency, and ultimately delivers outcomes in the best interests of consumers.

ERM Power appreciate the AER's attempt to achieve a balance between requiring AEMO apply either an overly prescriptive or flexible approach to selecting ISP development paths. In the Issues Paper, the AER suggests that if the CBA guideline does not allow for flexibility, it will be highly detailed and limit the utility of AEMO's expertise. Conversely, the AER also acknowledges that a prescriptive approach will provide improved transparency for stakeholders on AEMO's approach to conducting the ISP CBA. Although we understand that the AER is seeking to achieve a balanced approach to flexibility, ERM Power believe that the currently proposed approach to flexibility does not adequately consider the risk that consumers bear if AEMO's selection of optimal development path proves to be incorrect. We suggest that the current level of flexibility proposed to be given to AEMO is too high and caution the AER's support for AEMO's discretion in developing the number and nature of reasonable scenarios. Considering consumers bear the long-term costs of investment decisions, prescription should be prioritised over flexibility to minimise this risk to consumers.

We agree with the AER's initial view that the reasonableness of inputs and assumptions is promoted by transparency in the development and decision-making process, internal consistency, reputable and independent sources and sensitivity analysis. This must be achieved through effective consultation between AEMO, TNSPs and stakeholders. Ensuring this transparency, consistency and independence is adequately monitored through the application of the guidelines will serve to build stakeholder trust in the process and may allow for increased trust in a flexible approach to be adopted in the future.

Optimal development paths

A core element of the ISP is the selection of optimal development paths for the NEM. Considering the intended role of development paths for driving investment signals, it is important that there is clear oversight from the AER on their selection according to clearly defined criteria. The AER has stated their initial view that AEMO should select development paths that are commercially and technically feasible, consider non-network substitutes to network investment and based on a representative sample of the full range of possible transmission development paths. Additionally, the AER has an initial view that the ISP's counterfactual development path should reflect the status quo and contain no ISP or non-ISP projects that are not already committed.

We agree with the AER's initial views on AEMO's selection of development paths and counterfactual development paths. However, we reiterate that these paths should be selected in consultation with stakeholders. The selection of development paths should not be limited to only sequential ISP projects but may also include the assessment of different ISP projects which have the potential to meet the stated need. The selection of the counterfactual development path(s) should include minor network replacement, upgrades and augmentations works and alternative generator development plans. Any of these could result in a reduction in the claimed benefits of an ISP

project. This could produce an outcome where a net benefit is no longer delivered or where a significant capital expenditure in network investment indicated in an ISP project could be deferred, without impacting overall costs to consumers.

As previously stated, ISP development paths may represent planning scenarios of significant complexity. Future market development scenarios will be strongly dependent on the input assumptions, including the location of new energy generation or storage resources. In determining potential future market development scenarios, the AER's guidelines should require AEMO to provide significant detail regarding their selected locations for new generation resources used in the scenarios, including justification of their selection.

Where an ISP project only provides a net benefit on the assumption that a specific level of new uncommitted energy generation resource expenditure occurs in tandem with that network project, it should be the total costs of network and generation that must deliver a net benefit. Otherwise, we risk building expensive network infrastructure where an alternative and lower cost development path may exist, and where the network infrastructure is underutilised.

The ESB has proposed that all network projects within the ISP should be classified as committed when undertaking the CBAs for individual projects in the subsequent RIT-Ts. We believe that this will risk double or multiple counting of the same market benefit during each subsequent RIT-T process for each individual project. Where the realisation of benefits associated with a network development option relies on the development of other network options, we believe the CBA must be based on the total cost of all projects required to realise the benefit, rather than only the cost of the individual project under RIT-T assessment. When assessing the individual project, an additional assessment should be undertaken without the inclusion of other non-committed or approved projects. This would include any nominated ISP projects still awaiting completion of their RIT-T assessment.

The ISP may present a clear system plan for the development of Renewable Energy Zones (REZs). However, this component of the ISP has raised concerns regarding the potential development of transmission assets in the absence of new connecting generator development. ERM Power encourage the AER to consider whether the ISP guidelines could minimise this risk through placing limitations on the number of REZs approved for construction at any given time. For example, the ISP could identify the two most optimal projects in a region at a specific time identified in the ISP process to be considered for RIT-T completion. It could be mandated that no further development of a REZ would be approved until the optimal two projects identified are fully utilised by committed generation.

Alternative approach to benefit modelling

The CBA guideline provides guidance on how an identified need relating to actionable ISP projects must be described and modelled. Given AEMO's modelling is at the development path level, the description of the identified need could potentially be driven by the optimal development path as determined by AEMO and the actionable ISP projects within it. In this case, the identified need could be defined to correspond to the optimal development path selected, as opposed to describing the identified need to meet consumers future requirements. The AER considers the identified need AEMO determines for an actionable ISP project should maintain the integrity of the optimal development path, while allowing TNSPs to explore different credible options in applying the RIT–T based on more granular information at the individual project level. We believe that an identified need should not be described to maintain a certain optimal development path if it overstates the need of consumers and alternative solutions are found.

The modelling of benefits is key to ensuring costs to consumers from transmission investments are fairly allocated. We propose that a preferable approach to benefit modelling could be employed for both ISP and non-ISP projects, based on the following comparison of options:

1) Base case – state of the world without the credible option
2) Credible option only
3) Credible option plus other complementary ISP projects[2].

We propose that this approach would increase the costing accuracy through the CBA of ISP development paths, as it provides an accurate cost comparison of the credible option in isolation, as compared to the complementary ISP investments that would be required under a specific development path. The credible option could be modelled with only committed generation included. AEMO would then determine the amount of generation resources required to fully utilise the ISP project, with this shown as a cost against that ISP project. This would allow different network development paths to be compared to each other. One ISP project could have a mid-range development cost but little committed generation, whereas another higher cost network project could have very high committed generation. It should be the project with the highest net benefit overall that then proceeds, accounting for the costs of building uncommitted generation.

In considering situations where the TNSP selects the ISP defined project as the one and only assessed option, and where the costs of the project as determined by the TNSP exceeds the costs as set out in the ISP by 10%, the TNSP should be required to assess the net benefit under the full range of potential market development scenarios in accordance with the current RIT–T application guideline.

The "identified need"

The AER has proposed that the ISP guidelines will include a process to ensure the preferred option from the RIT-T process aligns with the ISP. ERM Power have interpreted this requirement as a process to ensure that the preferred option meets the "identified need", rather than a requirement to mirror the preferred project defined in the ISP. In our view, it should be clearly stated in the guidelines that it is the requirement that the preferred option meets the "identified need" at greatest net benefit.

Dispute resolution

It is important to maintain integrity of process for AER to retain authority for the dispute mechanism process. We believe that stakeholders should not be restricted in the matters raised through the dispute mechanism process. There should be additional oversight through the application of the guidelines to include a disputes resolution mechanism. We believe this mechanism should allow stakeholders to challenge AEMO decisions in formulating the ISP's network development options. We believe the AER should play a key role in regulating a disputes process, which allows for disputes to be raised at all stages of the development of the ISP and particularly following consultation on the draft ISP via an AER regulated disputes process.

[2] This option would be based on the costs of all included complementary ISP projects, not just the project under consideration.

The draft ISP rules propose that disputes are to be limited to matters of process. We believe it is essential to ensure the AER is permitted to appropriately fulfill its role, as indicated in the National Electricity Law[3]. This will provide confidence to consumers and other stakeholders that the objectives of the National Electricity Objective (NEO) are being achieved. As such, the AER must retain the capability to independently assess the merits of the proposed network development plan or individual project as part of the RIT-T process, before inclusion of the project costs in the relevant TNSP's regulated asset base. This could be undertaken by the AER during the contingent project application stage.

Please contact Ron Logan (rlogan@ermpower.com.au, 0427 002 956) or Emma White (ewhite@ermpower.com.au, 03 9214 9347) if you would like to discuss this submission further.

Yours sincerely,

[signed]

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[3] NEL Part 3—Functions and powers of the Australian Energy Regulator