

NSW REZ Supporting Guidelines: *Electricity Infrastructure Investment Act 2020*

- Confidentiality Guideline
- Cost Allocation Guideline
- Legal & Functional Separation Guideline
- Incentive schemes for non-contestable network project in NSW

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Public Forum - Monday 14 August 2023

Acknowledgement of Country

We wish to acknowledge the Traditional Custodians of the land we are meeting on today.

We pay our respects to them and their cultures and to their Elders past, present and emerging. We acknowledge their continuing connection to the land, sea and community.

We would also like to acknowledge and welcome any Aboriginal and Torres Strait Islander people who are attending today's event.



AGENDA

Brief overview

- Purpose of each guideline
- Key features of each guideline
- At the end of each guideline's section, ill ask for questions
- Slides will be posted on website this week



SUPPORTING GUIDELINES

Four Guidelines/Guidance Note:

- Confidentiality
- Cost Allocation
- Legal & Functional Separation
- Incentives Scheme (guidance note)

Aligned with the NER as closely as possible.

Adjustments made for *Electricity Infrastructure Investment Act 2020*.

Releasing them as one package.

Release finals in September 2023.



COST ALLOCATION - CONCEPT

Primary aim is to prevent cross-subsidisation

- Where a Network Service Provider uses revenue from a regulated (monopoly) service, to offer a below-cost-price in competitive market.
 - Using their position as a monopoly provider to undercut competitors and undermine competition over time to generate greater profit.
- Distorts competitive markets and competitive outcomes by driving down competition and reducing innovation. Consumers lose out.

The Guideline addresses this risk by requiring Network Service Providers to separate their costs by service type, and have this separation verified by an independent auditor.

- We see this separation in the historical and forecast expenditure in revenue proposals, annual reporting, pricing etc.

Under the NER, defined service categories are:

Transmission Services	Distribution Services
Prescribed (regulated)	Direct Standard Control (regulated)
Negotiated	Negotiated
Other Transmission services	Other Distribution services
Other services (non-transmission)	Other services (non-distribution)

Ultimately – the guideline ensures costs of service delivery are appropriately/accurately recorded against the type of service delivered.

COST ALLOCATION - OPERATION



Network Service Providers have some discretion over how they allocate costs.

- Particularly for distributing shared costs between service types (ie, corporate/HR costs).
- They must document how they'll do it, submit to us for approval, and publish it on their own website.
- This is their cost allocation methodology.

Must use this methodology when submitting to the AER:

- Forecast expenditure (opex and capex),
- Prices for negotiated services,
- Annual statements

Must be verified by an independent auditor.

The EII Act defines services differently.

- So services have to be allocated/separated across different service types.

Service Types:

- EII Regulated Activities (defined in the EII Act)
- Other Regulated Activities or Services (defined ourselves)
- Other Activities or Services (defined ourselves)

We have defined these, so the EII Cost Allocation Guideline can accommodate both NER operators and EII operators.

COST ALLOCATION - MAPPING



The EII Service categories can be mapped to the NER service categories.

EII Services	NER Transmission	NER Distribution
EII Regulated Activities	<ul style="list-style-type: none">• Prescribed Services	<ul style="list-style-type: none">• Direct Standard Control Services
Other Regulated Activities or Services		
Other Activities or Services	<ul style="list-style-type: none">• Negotiated Services	<ul style="list-style-type: none">• Negotiated Services
	<ul style="list-style-type: none">• Other Transmission Services	<ul style="list-style-type: none">• Other Distribution Services
	<ul style="list-style-type: none">• Other services (non-transmission)	Other services (non-distribution)

COST ALLOCATION - EXAMPLES

New Network Operator (no existing CAM):

- Regulated Activities under EII
 - Each revenue determination separately identified
- Other Regulated Activities or Services
 - Should be none (because otherwise they'd have CAM)
- Other Activities or Services
 - Competitively supplied services

Existing Transmission/Distribution Network Service Provider:

Subject to NER & EII guidelines:

- Regulated Activities under EII
 - Each revenue determination separately identified
- Other regulated Activities or Services:
 - Prescribed Transmission
- Other activities or services
 - Negotiated Transmission
 - Other transmission services
 - Other services



LEGAL & FUNCTIONAL SEPARATION – RING FENCING

Primary aim is to address the risks of cross-subsidisation & discrimination:

- **Cross Subsidisation** - where a Network Service Provider uses revenue from a regulated (monopoly) service, to offer a below-cost-price in competitive market.
- **Discrimination** – where a Network Service Provider uses its position (or information it gains) as a monopoly service provider to discriminate in favor of itself or it's affiliated entities, against competitors.



The NER ring-fencing guideline/s address these risks by:

- Preventing monopoly providers from delivering services in competitive markets.
- Be legally and functionally separate from entities that do.
- Imposing limitations on information sharing and staff sharing.

There are some exceptions to these, conceptually the above is accurate.

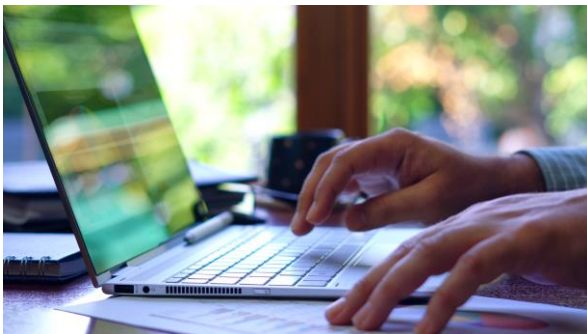
- The AER can waive some of these requirements where appropriate (the waiver system).

LEGAL & FUNCTIONAL SEPARATION - TYPES

The NER transmission RF Guideline prevents a transmission provider from delivering non-transmission services (with some exceptions).

So it allows a TNSP to deliver:

- Prescribed (regulated) services
- Negotiated services
- Other transmission (non-regulated) services



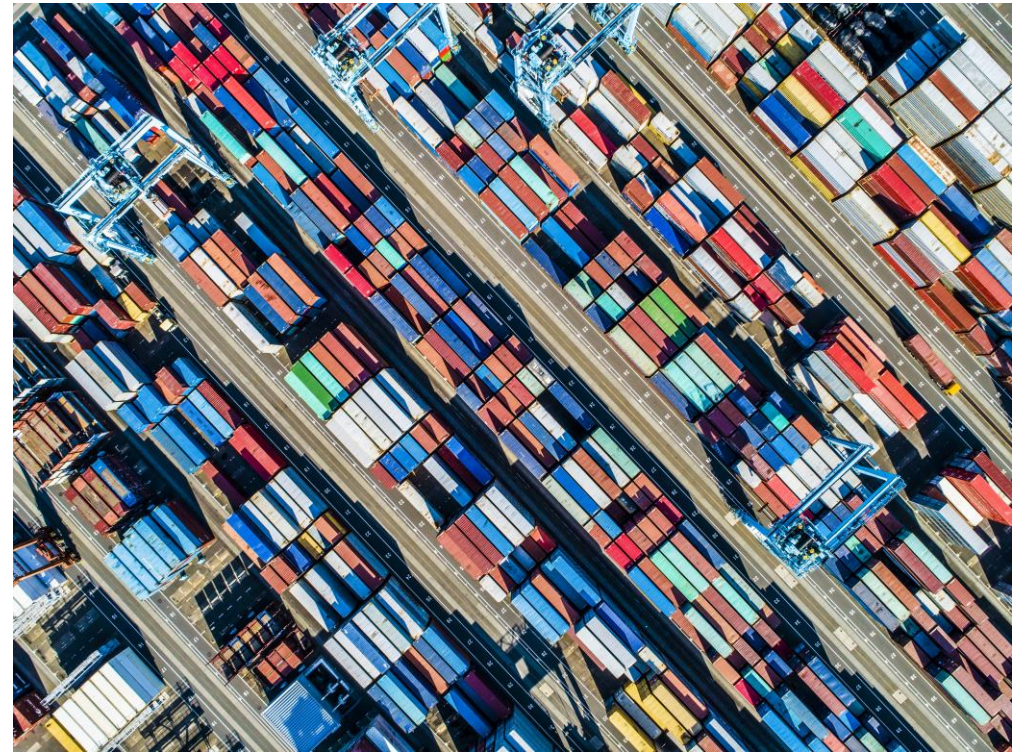
- Imposes obligations on TNSPs to not discriminate against competitors in favour of affiliated entities.
 - We use compliance reporting to confirm and monitor.
 - Separate accounts must be maintained, recording all transactions with affiliated entities.
- Imposes restrictions on information sharing between a TNSP and an affiliated entity unless the whole market has access.
- Imposes separation of marketing/sales staff from also be operational staff.
 - This prevents unfair information sharing.

There is a Distribution ring-fencing guideline too.

LEGAL & FUNCTIONAL SEPARATION

TNSPs and DNSPs are subject to NER Ring-fencing guidelines for services they provide under the NER.

A TNSP or DNSP that becomes a Network Operator will be subject to both guidelines.



LEGAL & FUNCTIONAL SEPARATION: SERVICE SEPARATION — NO ADDITIONAL LIMITATIONS

NER Ring-Fencing requires separation of:

- Prescribed and negotiated services and other transmission services from:
- Other services (subject to any waiver).

EI Legal & Functional Separation requires:

- No separation of services — subject to NER ring-fencing guideline.

Allows NO to deliver existing services under NER, as well as EI services.

- Use a waiver system for exceptions.



LEGAL & FUNCTIONAL SEPARATION: MAIN OBLIGATIONS

Staff separation – cant work on both regulated services and non-regulated services.

- Same as the NER.

Limits information sharing:

- Between other entities and between areas of Network Operator delivering different services.
- Same as the NER.

Introduces a waiver system:

- Same as NER.

Staff cant work on both a tender application and the REZ network planning for that project, and must be physically separated from those that do.



INCENTIVE SCHEMES (NER)



- Network Service Providers are incentivised to reduce their costs over time, by allowing them to keep some of the savings.
- This incentive declines over the regulatory period.
 - Implementing changes gains you more savings at the start of a regulatory period compared to the end.
- The Efficiency Benefit Sharing Scheme (EBSS) and the Capital Expenditure Sharing Scheme (CESS) extended the period that a Network Service Provider may keep these savings by factoring the savings into the RAB.
- Underspends
 - Network Service Providers keep 30% of underspends as extra revenue for 6 years.
 - Consumers get 70% of underspends as lower prices.
- Overspends
 - 30% of overspends are absorbed by the Network Service Provider.
 - 70% of overspends are passed to consumers (through higher prices).
- The schemes give a stronger incentive to manage allowance under the cap imposed by the determination (because otherwise they have to pay more).
- The application of incentive schemes to large scale transmission projects is a bit different.
 - These are subject to individual determinations (meaning you cant reprioritise between projects)
 - Capex heavy, with long build times, so increased potential for cost blow-outs.
 - We incorporated more flexibility in how we apply them:
 - Vary the sharing ratio or
 - Not apply
 - Use adjustment mechanisms

INCENTIVES SCHEMES (EII)

For our purposes:

- We are required to create incentives for economic efficiency under the EII Act.
- Some challenges in applying the EBSS in the first period (no historical trend to base on).
- EBSS – at the end of the first reg period, we will decide whether or not to apply EBSS to second reg period.
- We expect to apply the EBSS from the second period.

Some challenges in applying the CESS, because they are individually regulated projects.



We have used some factors for considering how we apply the CESS. These are consistent with those raised in the incentives review:

- What is proposed
- Benefits to consumers
- Size of the project
- Degree of uncertainty
- Actions taken to minimise risk exposure
- Stakeholder views

CESS- default position is that it will apply. This is our starting point.

CONFIDENTIALITY

Outlines how entities may:

- submit confidential information to us and
- claim confidentiality over it, and
- how we'll consider the claims.

Covers all 4 major responsibilities under the EII Act:

1. Revenue determinations
2. Contribution determinations
3. Approving risk management framework
4. Tender rule consultations

Same 4 steps for all functions:

1. Pre-lodgement discussions
2. Submission and making a confidentiality claim
3. Regulatory decision and publication decision
4. Communicate decision in advance



CONFIDENTIALITY: CRITERIA FOR CONSIDERING CONFIDENTIALITY CLAIMS

1. The public interest
2. Extent to which publication will disclose confidential information
3. Effect on future competitive assessment processes

Default position is we publish information we use in making our decisions and the information we are required to publish.



AER NEXT STEPS

Milestone	Indicative Dates
Public consultation period ends. Submissions due.	23 August 2023
Review of submissions & redraft guidelines.	23 – 1 September 2023
Publish guidelines.	13 September 2023
Annual review of guidelines.	July each year

- Submissions can be made by contacting us at REZ@aer.gov.au
- Instructions are in the cover of each guideline.
- Note: we publish submissions.
- Contact us for individual briefings and discussions.
- If in doubt, contact us.



QUESTIONS?

