Consumer
Challenge
Panel

Submission to the Australian Energy Regulator (AER)

Consumer Challenge Panel

CCP submission to the AER on Transgrid's 2024-29 Revenue Proposal in regard to the Waratah Super Battery (WSB)

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Confidentiality

To the best of our knowledge this advice neither presents any confidential information nor relies on confidential information for our comments.

1. Introduction

1.1. The role of the Consumer Challenge Panel (CCP)

The AER established the Consumer Challenge Panel (CCP) in July 2013 as part of its Better Regulation reforms. These reforms aimed to deliver an improved regulatory framework focused on the long-term interests of consumers.

The CCP assists the AER to make better regulatory determinations by providing input on issues of importance to consumers. The expert members of the CCP bring consumer perspectives to the AER to better balance the range of views considered as part of the AER's decisions.[1]

The views expressed in this paper are the views of the author in his capacity as the CCP member assigned to this project.

1.2. Background

This submission covers our views on some of the key issues that are to be considered by the AER in its response to Transgrid's 2024-29 Revenue Proposal in regard to the Waratah Super Battery (WSB).[2]

As set out on the AER website, the AER has a role in making revenue determinations for Network Operators who are authorised or directed to undertake network infrastructure projects. The AER is undertaking this role as Regulator under the NSW Electricity Infrastructure Investment Act 2020 (the EII Act).

On 14 October 2022, the NSW Minister for Energy directed Transgrid (as the Network Operator) to carry out the Waratah Super Battery (WSB) project, which is classified as a Priority Transmission Infrastructure Project (PTIP) under the EII Act.

The aim of the WSB project is to increase power transfer capacity on transmission lines that connect generation in the northern and southern regions of NSW to load centres in the Sydney / Newcastle / Wollongong region. The battery will operate as part of a broader System Integrity Protection Scheme (SIPS). The SIPS is designed to monitor transmission lines and enable the battery to act as a 'shock absorber' in the event of any sudden fault on the transmission system. The WSB project comprises the following four elements:

- SIPS battery service (contestable)
- Paired generation services (contestable)
- SIPS control system (non-contestable)
- Network augmentations (non-contestable)

On 30 June 2023, the AER received a revenue proposal from Transgrid for the non-contestable components (network augmentations and SIPS control system) of the WSB project. The revenue proposal sets out a schedule of quarterly payments that are proposed to be paid to Transgrid as the Network Operator for the non-contestable components of the WSB project.

[1] Detailed information on the CCP is available on the AER website at https://www.aer.gov.au/about-us/consumer-challenge-panel

[2] Relevant information on this regulatory process can be found on the AER's website at https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/waratah-super-battery-project-%E2%80%93-network-augmentation-and-sips-control-system-non-contestable.

The AER will make its revenue determination in accordance with the EII Act, the EII Regulations and the AER's *Transmission efficiency test* and *Revenue determination guideline for non-contestable network infrastructure projects*. Its determination will set out the amounts to be paid to Transgrid for the non-contestable components of the WSB project. These amounts will be based on the AER's assessment of the prudent, efficient and reasonable costs for the project. The AER will assess the costs using a modified version of Chapter 6A of the National Electricity Rules and other requirements as described in the EII Regulations.

The AER is currently assessing Transgrid's revenue proposal and will make a draft determination by 29 September 2023 and a final determination by 22 December 2023.

1.3. Issues considered in this submission

The AER held a public forum on Transgrid's revenue proposal on 18 July 2023, at which the AER and Transgrid presented with presentation slides. At that forum, we also presented our initial thoughts (without presentation slides) regarding what we would be looking at in our consideration of the Transgrid proposal.

In our presentation, we noted that this is the first non-contestable revenue proposal under the EII framework, and the first involvement of CCP under EII framework.

Given that Transgrid has been directed to undertake the project under the EII Act, the AER is not able to review the scope or timing of the project. Hence there is no role here for the CCP to provide any input on what is to be delivered as part of the project or when it is to be delivered – that is already settled under the EII framework. Assessment of the benefits that may arise to consumers from the project is also not part of the CCP remit, and the CCP lacks the expertise to examine proposed costs in detail.

Rather, our focus is therefore necessarily on specific aspects of the costs and risks from a customer perspective, as set out in this submission. This submission also examines the engagement undertaken by Transgrid with stakeholders, and particularly with customer stakeholders.

The remainder of this submission now discusses in turn the following relevant matters, which were foreshadowed in our presentation to the public forum:

- Customer and stakeholder engagement undertaken by Transgrid;
- Incentive schemes;
- Financeability; and
- Adjustment mechanisms.

2. Customer and stakeholder engagement undertaken by Transgrid

2.1. Customer and stakeholder engagement as set out in Transgrid's proposal

Customer and stakeholder engagement is discussed in Transgrid's proposal:

- A summary in four paragraphs in the Executive Summary (page 7); and
- Section 3: "What we have heard from our customers and other stakeholders" (pages 27-33).

2.2. Transgrid Advisory Council

Consistent with what is written in Transgrid's proposal, the only relevant engagement undertaken by Transgrid of which we are aware was through various meeting of the Transgrid Advisory Council (TAC). Presentation slides and meeting summaries from the TAC meetings are available on the Transgrid website.[3]

2.3. Our review of the customer and stakeholder engagement undertaken by Transgrid

We did not attend any of the TAC meetings, so our views of the effectiveness of the engagement undertaken by Transgrid are based on:

- Relevant material in Transgrid's proposal;
- Desk review of the published TAC materials; and
- Discussion with a TAC member whose role was to represent customers' interests.

2.3.1. TAC membership and remit

TAC was not specifically tasked with looking at the WSB project – its remit is much wider – and consideration of the WSB project was just a small component of what was discussed at TAC meetings. As stated on the Transgrid website:

> *The TAC meets monthly to discuss a variety of projects and energy transition issues.*

Transgrid's proposal states:

> *The TAC has been the primary forum for engagement on the development of this Revenue Proposal. The TAC is our executive level stakeholder forum with members representing consumer and business advocates, renewables generators and large customers.*

Our review of the TAC materials suggests that the TAC membership is wider than that, as per the Transgrid website which states:

> *TAC members come from a variety of organisations, representing electricity consumers, energy industry stakeholders and other subject matter experts.*

Transgrid's proposal continues:

> *The feedback and input we receive from TAC members on major projects and strategic policy issues helps to ensure that customer and industry needs and perspectives are addressed in the decisions we make.*

[3] See https://www.transgrid.com.au/community/stakeholder-engagement

2.3.2. TAC consideration of Transgrid's WSB proposal

The proposal states:

> *Where we have received specific feedback from the TAC, we have reflected it in this Revenue Proposal.*

Section 3 of the proposal – "What we have heard from our customers and other stakeholders" largely covers Transgrid's engagement approach, objectives and conduct more generally. Of relevance to the WSB proposal specifically, Transgrid states:

> *We discussed with the TAC that the need (i.e., driver), scope and timing of the Project is determined by the Ministerial Order. The TAC acknowledged that, given this, decisions on these matters are outside of our control and, as a result, there is little opportunity for collaboration or influence with the TAC on these matters. Our engagement with the TAC on need, scope and timing for the Project, therefore, focused on informing rather than involving or collaborating.*

The proposal states in regard to an incentive scheme:

> *On 7 July 2023, at the TAC's request, we will hold a deep dive to further discuss this matter and better understand the TAC's views and positions.*

This deep dive was to occur after the proposal was submitted on 30 June 2023, and further demonstrates that Transgrid did not understand the TAC's views and positions on this matter (as with other matters) before finalising its proposal.

Our review of the TAC materials confirmed for us that Transgrid's engagement focused on informing rather than involving or collaborating. We accept the view of Transgrid that there was little opportunity for collaboration or influence with the TAC, because under the EII framework much was outside Transgrid and stakeholder control. However, we found no evidence that any opportunity was taken for collaboration or influence with the TAC even in those areas where there were options that stakeholders could influence, such as those considered in this submission.

Our discussion with a TAC member also confirmed and informed us that:

- There was a one-way flow of information from Transgrid to TAC.
- There was not meaningful engagement in the way that is generally understood. Meaningful engagement at minimum requires the proponent to take steps to understand the preferences and values of stakeholders, and this did not occur.
- For example, Transgrid presented its view that the incentive scheme was not fit for purpose and how would it secure a margin if the incentive scheme applies, which is not the same as considering stakeholder preferences.
- Generally, TAC members did not have sufficient resources or information to object to any aspect of Transgrid's proposals. Transgrid did not provide any options for TAC members to choose between them, and TAC members were in no position and had no resource to come up with their own proposals and argue against Transgrid in any meaningful way.

2.3.3. Our conclusion regarding the engagement undertaken by Transgrid

Notwithstanding Transgrid's statement:

> *Where we have received specific feedback from the TAC, we have reflected it in this Revenue Proposal.*

Our review of the proposal, the TAC materials and our discussion with a TAC member have all confirmed that Transgrid's engagement ***focused on informing rather than involving or collaborating***. Consistent with this, we have not found any aspect of Transgrid's Revenue Proposal that has been influenced or changed based on specific feedback from the TAC.

We conclude that the engagement that Transgrid undertook with stakeholders does not provide a basis for the AER to deduce that stakeholders support any aspect of the Transgrid proposal (or otherwise).

We suggest that Transgrid might consider changing its future approach to stakeholder engagement if it wants to undertake meaningful stakeholder engagement (and particularly customer engagement) to inform and influence its revised proposal, as well as other future projects. These changes might include:

- Dedicating sufficient time to engagement on each individual project, rather than just subsuming within an existing engagement framework.
- Taking time to understand stakeholders' preferences and values and using those to formulate meaningful viable options for stakeholders to consider and choose between. Preferably co-designing those options with stakeholders in the formulation of policy positions.
- Focusing in its engagement on stakeholders' preferences and values rather than just Transgrid's preferences, and on engagement aspects where stakeholders could influence outcomes at engagement levels of involving and collaborating.
- Setting out in its proposal how the proposal has been informed and influenced by stakeholder engagement, thereby giving the AER and CCP opportunity to take stakeholder influence into account in their assessments of revenue proposals.

3. Incentive schemes

3.1. Transgrid's views on incentive schemes

Section 9 of Transgrid's proposal sets out Transgrid's views in regard to application of the incentive schemes to the WSB (non-contestable) project. As summarised in the Executive Summary:

For this Project, the AER's non-contestable Guideline explains that the AER intends to:

- *apply the same expenditure incentive schemes, being the Efficiency Benefit Sharing Scheme (EBSS) and Capital Expenditure Sharing Scheme (CESS) that currently apply under the NER*
- *develop an EII-specific Service Target Performance Incentive Scheme (STPIS), which would apply only from the second regulatory control period, and*
- *not apply either the NER small-scale incentive scheme or the demand management innovation allowance mechanism.*

We agree with the AER's position, with the exception of the proposed application of the EBSS and the CESS. We do not support the application of the EBSS and CESS to the NSW Roadmap or AEMO's ISP projects. This is because, in an inflationary and uncertain operating environment with high value, complex and specialised projects, these incentive schemes introduce an asymmetric risk.

3.2. Our views on how incentive schemes should apply to this project

We comment here specifically on whether the EBSS and CESS should apply here, because as set out in the proposal, this is where the views of Transgrid and the AER differ. We recognise that:

- There is risk to Transgrid in applying these incentive schemes.
- Transgrid claims that the probability of overspending the AER's capex allowance is greater than the probability of underspending it.

The converse is that if the incentive schemes do not apply, all the risk of overspending falls to customers. Customers clearly have no ability here to influence and control spending outcomes, so they are in a much worse position than networks when it comes to controlling project costs. As a general principle, any sharing of risk framework must be co-positioned with where risk management can best be implemented, so we see no case for all the risks sitting here with customers.

Regulation of network businesses in Australia operates on the basis of incentive based regulation, rather than paying all costs of network businesses on an "as incurred" basis. This incentive based regulation approach enables risk sharing between network businesses and customers, and has consistently been supported enthusiastically by network businesses, and by Energy Networks Australia, the national industry body representing Australia's electricity transmission and distribution and gas distribution networks.[4]

The incentive schemes framework is effective only if there are risks in both directions – sometimes network businesses will gain financially from the application of the incentive scheme and sometimes network businesses will lose financially from the application of the incentive scheme. If one side

[4] See for example submissions to the AER's recent review of incentive schemes at https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/review-of-incentive-schemes-for-regulated-networks

always gains, then the scheme is simply a mechanism for that side to enjoy unjustified additional windfall revenues, which would be inappropriate.

We contend that if networks “cherry pick” so they accept and embrace incentive schemes where they believe they will gain and reject incentive schemes where they believe they will lose, that is creating a grossly inappropriate imbalance of risk and opportunity between networks and customers. Put another way, if incentive schemes are rejected if and only if networks perceive an asymmetric risk that goes against them, that does not correct asymmetry but rather creates asymmetry in favour of the interests of networks and against the interests of customers.

On that basis, the AER should apply the EBSS and CESS to this project.

4. Financeability

4.1. Transgrid's views on financeability

Transgrid references issues with regard to financeability in various places in its proposal. In particular, in section 6.5 – "Financeability cashflow adjustment":

> *Projects are financeable if equity investors have confidence that they will be able to earn a reasonable return for the risk associated with the project, and that the allowed regulated cashflows associated with the project will be sufficient to support the benchmark credit rating (BBB+) at the benchmark level of gearing (60 per cent).*

Transgrid further states:

> *Our view is that the regulated cashflows associated with the WSB project should be sufficient to support the AER's BBB+ benchmark credit rating at the benchmark gearing level of 60 per cent in each year of the regulatory period.*

Focusing on that basis on financeability and credit ratings based solely on cashflows at the WSB project level, Transgrid proposes a new algorithm based on examining a very limited set of parameters, which will determine:

- whether a "financeability problem" exists in any year of the regulatory period, and if so
- how much additional regulated cashflow would be required in that year to address that "financeability problem".

Once that additional regulated cashflow is determined, Transgrid proposes to gain that additional regulated cashflow by providing that the depreciation allowance for this project should in part be determined on the basis of 'as-incurred' capex rather than 'as commissioned' capex.

As set out by Transgrid:

> *Typically, for prescribed transmission services under the NER, a depreciation allowance would be provided only once capital assets have been commissioned. Consequently, this results in reduced cashflows being available to the provider of the prescribed transmission services during the construction of new assets, which may contribute to a financeability problem for the firm. We propose that, for WSB, the depreciation allowance would be provided on capex as it is incurred. This would deliver higher cashflows to the project in its early years.*

4.2. Our views on financebaility

We start by noting that what Transgrid refers to as "regulated cashflows" are from a customer perspective payments from customers which affect customers' cashflows. Transgrid provides no analysis of how customers are affected by changes to their cashflows, and instead only see cashflows from Transgrid's perspective. This is not a customer-focused proposal.

Usually a depreciation allowance would be provided only once capital assets have been commissioned. This means that customers only start to pay the return of capital (through depreciation) when they start to benefit from the capital expenditure.

On the other hand, Transgrid's proposal will result in customers starting to pay the return of capital before any benefit from the capital expenditure can be enjoyed. This is not the usual timeframe, and we do not think it reasonable to require customers to make earlier payments, which will adversely affect their cashflows, before they start to see project benefits.

We also note that Transgrid has framed "financeability" and whether there is a "financeability problem" solely in relation to the regulated cashflows directly attributable to the WSB project, and based on examining a very limited set of parameters. We do not accept that to be the appropriate framing. First, investors looking to invest in Transgrid are more likely to be looking at Transgrid's overall credit rating rather than create a credit rating for each individual project in which they invest based on a very limited set of parameters. Second, if investors are looking particularly at the project then they are doing so in the context of this being a long-term infrastructure project within a portfolio of investments, which will provide stable, predictable and dependable cashflows on an ongoing long-term basis. They are unlikely to be put off by cashflows only arising once capital assets have been commissioned, as that is industry standard for their investments.

On this basis, we are not convinced that a "financeability problem" exists that needs to be addressed, and therefore we advise that the AER should reject early depreciation that adversely and unnecessarily affects customers' cashflows.

Finally we note that standard depreciation schedules have an accounting-standard or technical or economic-life basis, in this case using straight-line depreciation. On the other hand, the Transgrid proposal is to create a separate depreciation schedule for a new asset class 'Financeability Asset', reallocating assets to this asset class each year on a year-by-year basis, through backcasting of a supposed required regulated cashflow as a kind of a "goal seek" adjustment. This does not sit well with what depreciation is really meant to represent.

We do not support providing Transgrid with an earlier regulated cashflow. Even if we were convinced that an earlier regulated cashflow is appropriate (which we are not), we would not support the mechanism proposed to achieve it.

5. Adjustment mechanisms

5.1. Transgrid's views on adjustment mechanisms

Transgrid's proposal addresses adjustment mechanisms in section 12:

In relation to adjustment mechanisms:

- *In some cases, these will be 'automatic', in the sense that the AER would not be required to review or remake its revenue determination. In this Revenue Proposal, we propose annual updates to revenue for actual inflation, the return on debt update to the allowed rate of return, and additional contractual payments to EnergyCo, and*
- *In other cases, these would be 'non-automatic', such that the AER would be required to review or remake its revenue determination. For instance, the occurrence of a significant event (non-automatic adjustment mechanisms).*

…

We propose three non-automatic adjustments:

- *paired generation cost*
- *unavoidable contract variations, and*
- *contractor force majeure.*

5.2. Our views on adjustment mechanisms

We see reasons why there is basis for these adjustment mechanisms. We look to the AER to analyse the proposed adjustment mechanisms, as they have more available resource for this than we do. On that basis, we provide no further comment at this stage, but may comment further on the AER's Draft Decision / Transgrid's Revised Proposal.