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Wednesday, 23 August 2023

Kami Kaur
Acting General Manager,
NSW REZ Branch
Australian Energy Regulator
GPO Box 3131 Canberra ACT 2601

Submitted by email: REZ@aer.gov.au.

Dear Kami,

AER Draft NSW supporting guidelines

Transgrid welcomes the opportunity to respond to the Australian Energy Regulator's (**AER**) draft supporting guidelines that support the regulation of network infrastructure projects under the NSW Electricity Infrastructure Roadmap.

In our role as the transmission planner, asset manager and operator for NSW and the ACT, Transgrid has developed unique expertise and capability in managing one of the key networks in the National Electricity Market. Our primary responsibility is to ensure the ongoing security and reliability of the network as it transitions to higher renewables penetration supporting Australia's carbon reduction target of 43% by 2030 and net zero by 2050.

We appreciate the AER's general approach to the draft guidelines and its endeavour to ensure consistency between the national framework and the NSW specific guidelines. In reviewing the guidelines, we have identified a number of key issues for further consideration by the AER prior to finalising the guidelines. These are outlined below under the relevant draft guideline.

Incentive schemes for non-contestable network projects in NSW: Guidance Note Draft

Application of the Efficiency Benefit Sharing Scheme (EBSS) or Capital Expenditure Sharing Scheme (CESS) to NSW infrastructure projects presents a number of challenges each of which discourage the much needed private sector investment in these large-scale critical infrastructure projects. Specifically:

Efficiency Benefit Sharing Scheme (EBSS)

The AER states that it has the discretion to apply EBSS to the initial regulatory control period and the subsequent regulatory control periods. Additionally, the AER states that applying the EBSS in the initial period will be difficult because:

- the Network Operator will not have historical revealed opex to base forecast on (given it is starting fresh),

- the initial period will be largely a design and construction phase during which, there cannot be a steady or recurring state of opex; and
- EII Act non-contestable projects are one-offs and bespoke and therefore suitable benchmarking may not be helpful/utilised.

We agree with the AER that it will be difficult to determine the EBSS for the above-mentioned reasons and therefore believe the EBSS should not be applied to opex incurred in the first regulatory period when the assets are created as it does not have a base year for opex.

We strongly encourage the AER not to apply the EBSS, however if the AER does apply the EBSS to opex incurred in the first regulatory control period, or indeed in any subsequent regulatory control periods; we encourage the AER to provide greater certainty ahead of time to the Network Operator when it intends to apply the EBSS. Whilst the AER regularly engages and consults with Network Operators of its intentions on matters such as the application of EBSS, Transgrid proposes that this be reflected in the guidelines.

The AER has also stated that it will have discretion to apply the EBSS at the completion of the second regulatory control period if the Network Operator's opex hasn't reached a steady state by the end of the initial regulatory control period, inhibiting the base-step-trend forecast methodology. As with the discretionary approach on the initial regulatory control period, Transgrid believes this does not provide Network Operators with certainty in the mechanism of the incentive scheme. It is highly irregular and unreasonable to expect major investment decisions to be made without full knowledge of whether incentives or penalties will apply after the expenditure is incurred. In our opinion, incentives should be known upfront.

RECOMMENDATION: Transgrid encourages the AER to include a statement in the guidelines to the effect that the AER will regularly engage with Network Operators during the relevant period to keep them informed as to the AER's intention on whether the AER will apply EBSS to opex incurred in that period.

Capital Expenditure Sharing Scheme (CESS)

The CESS is intended to balance incentives for businesses to achieve efficiencies across a regulatory control period and encourages efficient expenditure within the total capex allowance in a regulatory period.

Transgrid agrees with the AER in recognising the difficulties in applying the CESS to EII Act projects.

Given the unique nature of the EII Act infrastructure projects, we do not consider applying the CESS to EII Act projects is appropriate. There are unique differences between capital expenditures under the national framework and the EII Act framework. The application of the CESS to EII Act projects has the potential to jeopardise the financeability of these projects.

The application of CESS introduces asymmetric risk as a result of the following factors that are beyond our direct control:

- We are being directed to undertake EII Act projects within highly-accelerated delivery timeframes in planning and regulatory systems not designed for rapid assessments.
- The projects are large size and scale, very high value, complex or specialised and cannot be re-prioritised across a portfolio of projects and programs. Under the EII Act's regulatory framework, each project is subject to its own revenue determination. This contrasts with the arrangements under the NER which relate to our entire capital portfolio for the regulatory period.
- The current economic environment is highly inflationary and uncertain due to rapidly increasing labour and materials costs, and skills shortages globally. In such an environment, contractors are unwilling or unable to offer fixed price contracts. The more than 2000 construction companies that have become insolvent in the past 12 months is further evidence of the pressure facing the industry.

RECOMMENDATION: The AER does not apply the CESS to EII Act projects.

Service Target Performance Incentive Scheme (STPIS)

The AER states that it will develop an EII Act-specific STPIS and that this scheme would apply to non-contestable determinations from the second regulatory control period onwards.

RECOMMENDATION: We welcome the exclusion of the STPIS in the first regulatory period. We encourage the AER to consult with us, as the Network Operator, and to carefully consider how the EII Act STPIS would work in conjunction with the NER STPIS.

Legal and functional separation guideline - Electricity Infrastructure Investment Act – Draft

Staff separation

The AER has set out four specific requirements that Network Operators must comply with in clause 2.2 of the legal and functional separation guideline. We have concerns in relation to the requirements set out in Clause 2.2 (c) and (d) which are included below:

- Clause 2.2(c) - staff involved in planning for network activities in consultation with the Infrastructure Planner (EnergyCo), are also not staff involved in preparing responses or submissions to contestable procurement processes for that network activity, and
- Clause 2.2(d) - staff involved in planning for network activities in consultation with the Infrastructure Planner (EnergyCo), are physically separated from staff involved in preparing responses or submissions to contestable procurement processes for that network activity, for the duration of the procurement process.

Transgrid makes the following comments on the proposed staff separation requirements set out in clause 2.2:

- Firstly, the references in clause 2.2 (c) and (d) to “staff involved in planning for network activities” could be interpreted too broadly, and could have unintended consequences, particularly having regard to the various interactions the different parts of Transgrid's business have with EnergyCo. We understand the AER's intention is the restriction should only apply to network planning staff.

RECOMMENDATION: To avoid any doubt, we suggest the wording should be expressly limited to “staff undertaking network planning activities associated with the NSW Roadmap and in conjunction with EnergyCo”. That is, it should be limited to staff that are network planning specialists and should not apply to other staff involved in planning for network activities.

- Secondly, Transgrid is concerned that the proposed physical separation of certain staff is out of proportion to the potential risk and is not operationally feasible. In our view, physically separating staff as described in clause 2.2(d) will be onerous and impose unnecessary costs on the business with no clear benefit to consumers. Such a requirement is inconsistent with the NER Transmission Ring-fencing Guideline and does not promote the National Electricity Objective.

RECOMMENDATION: We suggest the risk of unnecessary information sharing can be mitigated by maintaining appropriate confidentiality and information barrier protocols, as are currently in place, including lockdown of tender facilities, to manage information flows. If staff separation is required, then the extent of the requirements should be clarified. We would expect that it should apply only to the network planning staff involved in planning for a network activity and the contestable bid team for that network activity. As is the case under the Ring-fencing guidelines, it should exclude shared service providers. We strongly encourage the AER to maintain consistency between the NER Transmission Ring-fencing Guideline and the NSW Guideline. The final Transmission Ring-fencing Guideline, that was published in March 2023, determined that physical staff separation did not outweigh the costs. Given this decision was recently extensively consulted on, we would encourage the AER not to impose physical staff separation in the NSW guideline.

Cost Allocation Guideline - Electricity Infrastructure Investment Act Draft

The AER has stated that a Network Operator must make best endeavours to submit its proposed cost allocation methodology to the AER for approval at least 60 business days before the Network Operator’s revenue proposal is due for submission.

This timeframe presents challenges with revenue proposals already submitted to the AER such as the revenue proposal for the Waratah Super Battery that was submitted on 30 June 2023.

RECOMMENDATION: Exemptions would need to be considered by the AER for revenue proposals for a NSW infrastructure project that has already been lodged with the AER.

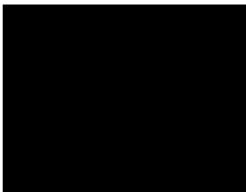
The AER also states that the Network Operator needs to include a statement in its cost allocation methodology that marginal increases in direct costs, as a result of including EII Act regulated activities, will match the marginal increases in shared costs (clause 3.2 (2)).

We are not clear as to the intent of this requirement. Given the scale of the EII Act projects, it is likely that increases indirect costs resulting from inclusion of an EII Act project will outweigh increases in shared costs.

RECOMMENDATION: We request the AER to clarify the purpose of this methodology or remove it from the guideline.

Transgrid looks forward to continuing to work with the AER to develop a workable, flexible and relevant Guideline that is in the best interest of consumers. If you or your staff require any further information or clarification on this submission, please contact Zainab Dirani on [REDACTED]

Yours faithfully



Maryanne Graham
Executive General Manager
Corporate and Stakeholder Affairs