Consumer
Challenge
Panel

Submission to the Australian Energy Regulator (AER)

Consumer Challenge Panel

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

David Prins

24 November 2023

Contents

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 the AER's Draft Decision and Transgrid's 2024-29 Revised 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 set 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/consumer-challenge-panel

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

The AER is making 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.

We made a submission to Transgrid's initial Revenue Proposal in August 2023. Subsequently, the AER issued a Draft Decision on 29 September 2023, and Transgrid submitted a Revised Revenue Proposal on 2 November 2023. This submission responds to the AER's Draft Decision and Transgrid's Revised Revenue Proposal. The AER is to issue a final determination by 22 December 2023.

2. Issues considered in our previous submission to Transgrid's Revenue Proposal in August 2023

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 our previous submission and in this submission. Our previous submission also examined the engagement undertaken by Transgrid with stakeholders, and particularly with customer stakeholders.

Our previous submission to Transgrid's initial Revenue Proposal discussed 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.

3. How the AER's Draft Decision and Transgrid's Revised Proposal addressed the issues we raised in our previous submission

This report section considers how the AER's Draft Decision and Transgrid's Revised Proposal addressed the issues we raised in our previous submission, these being:

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

3.1. Customer and stakeholder engagement undertaken by Transgrid

Section 2.5 of the AER's Draft Decision considered Transgrid's consumer engagement, and provided views which it said were consistent with those of the Consumer Challenge Panel. Transgrid's Revised Proposal does not specifically address customer and stakeholder engagement undertaken by Transgrid. We stand by our previous comments, and have nothing further to add here regarding customer and stakeholder engagement undertaken by Transgrid.

3.2. Incentive schemes

In our previous submission, we provided the view that the AER should apply the Efficiency Benefit Sharing Scheme (EBSS) and the Capital Expenditure Sharing Scheme (CESS) to this project, and gave our reasoning underlying that view.

Section 2.5 of the AER's Draft Decision considered the application of incentive schemes to this project.

In regard to the CESS, the AER stated:

> *We consider Transgrid is likely to have enough influence over the capex of the project, that if the opportunity for a capex underspend arises, it's more likely to be achieved with Transgrid's action than without it. As such, we consider applying the CESS to this project creates the best chance of reducing the cost of the project to consumers and is consistent with the capital expenditure objective.*

In doing so, the AER also stated that this draft decision was "finely balanced" and concluded: "We welcome interested stakeholders to provide submissions to inform our final decision."

In regard to the EBSS, the AER stated:

> *For the EBSS a decision on applying the EBSS will be made at the end of the first regulatory period as there is no historical opex upon which to base forecasts. When considering whether to apply the scheme, the AER will consider whether the opex is efficient and has reached a steady state on which forecasts may reasonably be based.*

Transgrid's Revised Revenue Proposal adopted the AER's Draft Decision to apply the CESS and EBSS.

Given that the AER stated that it would welcome interested stakeholders to provide submissions to inform its final decision regarding the CESS, that matter is discussed further in this submission. We have nothing further to add regarding the EBSS.

3.3. Financeability

In our previous submission, we stated:

> *… 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.*

We concluded:

> *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.*

In its Draft Decision, the AER stated:

> *Having assessed Transgrid's proposed approach to financeability, we do not consider Transgrid's proposed 'financeability test' to be fit for purpose*
>
> *… we do not accept the new 'financeability asset' asset class and remaining asset lives for all asset classes.*

The AER's Draft Decision was consistent with our views. Further, Transgrid's Revised Revenue Proposal adopted the AER's Draft Decision in this regard.

The AER also stated in its Draft Decision:

> *We will reassess our position on financeability for the final decision with any additional material Transgrid may provide that addresses our above concerns as part of its revised proposal.*

Given that Transgrid's revised proposal adopted the AER's Draft Decision in this regard, we see no reason for the AER to reassess its position on financeability for the final decision. On that basis, we have nothing further to add regarding financeability in this submission. In the unexpected event that the AER does see fit to reassess its position on financeability for the final decision, it should have regard to our previous submission on this matter.

3.4. Adjustment mechanisms

In our previous submission, we set out Transgrid's views on adjustment mechanisms, and concluded:

> *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.*

In its Draft Decision, the AER stated:

> *We have accepted the proposed adjustment mechanisms or accepted them with amendments.*

Transgrid's Revised Revenue Proposal correspondingly stated that the AER's Draft Decision:

> ***Accepted*** *our proposed* ***16 Revenue Adjustment Mechanisms****, with minor wording amendments to four of these mechanisms, to improve their clarity. We accept the AER's proposed wording amendments. We also accept the introduction of a capex cap (i.e., a maximum cumulative increase) of $30 million for the unavoidable contract variation adjustment mechanism.*

The AER's Draft Decision justifies the introduction of a capex cap (i.e. a maximum cumulative increase) of $30 million for the unavoidable contract variation adjustment mechanism on the following basis:

> *… allowing an adjustment mechanism to recover the full cost of any capital expenditure increase that Transgrid bears (as implied in the proposed mechanism) undermines the incentives created by an efficient revenue allowance. It also weakens the incentive provided by the CESS – as it effectively removes the expenditure cap with no penalty.*
>
> *Therefore, to balance these concerns, in accepting the adjustment mechanisms we have added an upper limit – a maximum cumulative increase of $30 million ($ 2023–24) over the regulatory control period ... We selected the maximum increase based on information provided to us by Transgrid.*
>
> *This approach allows Transgrid to recover the prudent, efficient, and reasonable costs of carrying out the network infrastructure project by accommodating the cost variations it has no control over. This ensures it isn't exposed to additional risk by taking a contracting approach that could lower the cost of the project overall (benefiting consumers) and maintains the incentive to manage its costs efficiently.*

We have no reason not to support this approach. Taking into account also that Transgrid has accepted this aspect of the AER's Draft Decision, we have no further comment to make on this.

3.5. Implications for this submission

Taking into account the above, the only material matter left to discuss in this submission is the application of the Capital Expenditure Sharing Scheme (CESS) to this project. This is considered in the next section of this report.

4. Capital Expenditure Sharing Scheme (CESS)

4.1. Transgrid's views on incentive schemes in its initial revenue proposal

Section 9 of Transgrid's proposal set 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.

4.2. Our views on how incentive schemes should apply to this project as set out in our previous submission

We commented in our previous submission specifically on whether the EBSS and CESS should apply to this project, because as set out in Transgrid's initial revenue proposal, this is where the views of Transgrid and the AER differed. We recognised 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.

We stated, based on the information available to us at the time, that 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.[3]

[3] 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

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

We contended 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, we stated that the AER should apply the EBSS and CESS to this project.

4.3. Overview of the AER's Draft Decision and Transgrid's Revised Revenue Proposal in regard to the CESS

As stated above, section 2.5 of the AER's Draft Decision considered the application of incentive schemes to this project.

In regard to the CESS, the AER stated:

> *We consider Transgrid is likely to have enough influence over the capex of the project, that if the opportunity for a capex underspend arises, it's more likely to be achieved with Transgrid's action than without it. As such, we consider applying the CESS to this project creates the best chance of reducing the cost of the project to consumers and is consistent with the capital expenditure objective.*

In doing so, the AER also stated that this draft decision was "finely balanced" and concluded: "We welcome interested stakeholders to provide submissions to inform our final decision."

Transgrid's Revised Revenue Proposal adopted the AER's Draft Decision to apply the CESS.

Given that the AER stated that it would welcome interested stakeholders to provide submissions to inform its final decision regarding the CESS, that matter is discussed further here.

4.4. Our further views regarding the CESS having had regard to the AER's Draft Decision

4.4.1. Relevance of the Network Operator Deed – the contractual arrangement between Transgrid and EnergyCo

The AER's Draft Decision introduced new information regarding whether the CESS should apply to this project, of which we were not aware when we made our previous submission.

Specifically, the AER refers to the Network Operator Deed as follows:

> *If CESS is not applied and there is an overspend the Network Operator faces no penalty for the overspend. In the case where CESS applies, in the event of an overspend the Network Operator Deed described further below is triggered. In both these cases there is no benefit to consumers.*

…

The Network Operator Deed contains a clause that provides the opportunity for Transgrid to seek recovery of the cost of a CESS penalty from EnergyCo, were one applied for a capex overspend. This influences the incentives Transgrid has in relation to undertaking efficient capital expenditure.

…

We are required to consider the interaction of the CESS with other incentives that network Operators may have in relation to undertaking efficient opex or capex. The contractual arrangement between Transgrid and EnergyCo (the Network Operator Deed) materially influences the incentive for Transgrid to undertake efficient capex. The Network Operator Deed contains a clause that provides the opportunity for Transgrid to recover the cost of a CESS penalty from EnergyCo, were one applied for a capex overspend. This clause doesn't guarantee Transgrid will move the financial burden of any CESS penalty to EnergyCo, but it provides it with the opportunity to do so, which weakens the incentive for Transgrid to manage its capex within the allowance.

The clause is asymmetric, in that it does not require Transgrid to pass on to EnergyCo, any benefit (ie, a CESS benefit payment) it may gain from an underspend. As such, applying the CESS provides an incentive for Transgrid to pursue an efficient capex underspend. However, this incentive is only effective where Transgrid has the ability to influence the capex of the project.

…

Due to the Network Operator Deed, any overspend on capex resulting in a CESS penalty will trigger the Network Operator Deed and hence the Network Operator's incentive to keep capital costs down is diminished. The existence of the Network Operator Deed hence makes the incentive regime asymmetric.

Not applying the CESS removes the primary incentive tool the AER applies to promote efficient capital expenditure. Any underspend or overspend on capex would be entirely borne by consumers as there is no benefit sharing, and Transgrid would have less incentive to pursue an underspend or avoid an overspend.

Clearly, knowledge of relevant contents of the Network Operator Deed, which is described by the AER as being the contractual arrangement between Transgrid and EnergyCo, is critical to informed stakeholder engagement on whether the CESS should apply.

The Network Operator Deed appears on the AER's website as supporting information – Attachment 14 – to Transgrid initial Revenue Proposal dated 30 June 2023. However, this document itself is dated 17 October 2023 in its filename on the AER website, which supports the fact that we had not sighted it, let alone understood its significance, when we made our previous submission on Transgrid's initial Revenue Proposal.[4] The document itself is 283 pages long, but it does not serve its expected purpose to inform this submission, because all 282 pages beyond the cover page are entirely blacked out.

[4] We first spotted the document on the AER website on 8 November 2023

A further document Attachment 15 – amendment to network operator deed – is also blacked out.

A document on the AER website regarding confidentiality claims seeks to justify the blacking out as follows:

Title, page and paragraph number (i.e. section and page number)	Description of the confidential information	Topic of the confidential information	Confidentiality category	Why the confidential information falls into the selected category	How and why detriment would be caused from disclosing the confidential information	Why the identified detriment is not outweighed by the public benefit	Number of confidential pages
Network Operator Deed							
Network Operator Deed, p. 2-283	Contract	Contractual agreement	Market intelligence	Public Disclosure could potentially harm Transgrid's commercial interests	Public disclosure could potentially harm TransGrid's and the third-party's commercial interests	We are not aware of any public benefit in publicly disclosing this information that could outweigh the detriment.	282 pages
Amendment to Network Operator Deed, p. 1-4	Contract	Contractual agreement	Market intelligence	Public Disclosure could potentially harm Transgrid's commercial interests	Public disclosure could potentially harm TransGrid's and the third-party's commercial interests	We are not aware of any public benefit in publicly disclosing this information that could outweigh the detriment.	4 pages

We respect commercial confidentiality where applicable. However, we do not accept that a commercial agreement naturally should have full confidentiality protection for the entire contents.

There is often some content in a commercial contract that is legitimately commercially confidential, but not the whole document. For example, there might be a table of manhour rates where the table heading, the row and column headings and all the surrounding text is visible, just the rates themselves are blacked out. That is perfectly normal and acceptable. There may also be other terms and conditions that are legitimately commercially confidential.

It is our view that declaring a whole document confidential is unlikely to be in the public interest.

Transgrid asserted:

> *We are not aware of any public benefit in publicly disclosing this information that could outweigh the detriment.*

This assertion has clearly not been accepted by the AER. The fact that the AER has disclosed material information contained in a document that is asserted to be confidential proves that the AER saw public benefit in disclosing this information that it believed would outweigh the detriment. It remains difficult for us to understand why the AER has accepted Transgrid's confidentiality claim while at the same time somewhat over-riding the claim by disclosing material information.[5]

[5] We asserted at the top of this document: "To the best of our knowledge this advice neither presents any confidential information nor relies on confidential information for our comments." We wish to confirm that we are not relying on any information that Transgrid has claimed is confidential, other than that which has already

We recommend that the AER should in future be more assertive in challenging what appear to be ambient confidentiality claims, and ensuring that draconian excessive blacking out does not in future occur where it is not justified.

4.4.2. Concerns arising from what has been disclosed by the AER regarding the Network Operator Deed – the contractual arrangement between Transgrid and EnergyCo

As stated above, it is the role of the CCP to provide input on issues of importance to consumers. We therefore see it as incumbent on us to consider the implications for consumers of the AER's disclosure that:

> *The contractual arrangement between Transgrid and EnergyCo (the Network Operator Deed) materially influences the incentive for Transgrid to undertake efficient capex. The Network Operator Deed contains a clause that provides the opportunity for Transgrid to recover the cost of a CESS penalty from EnergyCo, were one applied for a capex overspend. This clause doesn't guarantee Transgrid will move the financial burden of any CESS penalty to EnergyCo, but it provides it with the opportunity to do so, which weakens the incentive for Transgrid to manage its capex within the allowance.*
>
> *The clause is asymmetric, in that it does not require Transgrid to pass on to EnergyCo, any benefit (ie, a CESS benefit payment) it may gain from an underspend.*

We are of course not privy to negotiations and discussions between Transgrid and other parties, but prima facie these arrangements do not appear to be in the interests of consumers, and as far as we are aware there was no customer or public stakeholder engagement undertaken in framing these arrangements. We are not aware of any intent by the parties to make customers and other public stakeholders aware of this arrangement in the absence of the AER having disclosed the arrangement.

We commend to all parties to engage in public consultation and engagement, and to act to ensure that any arrangements put in place in future are in the interests of consumers.

4.4.3. Conclusions regarding the CESS

We have reviewed the AER's Draft Decision to apply the CESS to this proposal. We accept the AER's reasoning that applying the CESS to this project creates the best chance of reducing the cost of the project to consumers, and is consistent with the capital expenditure objective. Given the opaqueness of the Network Operator Deed, we would strengthen the AER's argument that we believe application of the CESS could help increase badly needed transparency on project outcomes and commercial arrangements, and that is a further reason to support application of the CESS to this project.

---

been placed in the public domain by the AER. Thus we are not disclosing any information here that has not already been disclosed by the AER.