



public interest
ADVOCACY CENTRE

**PIAC submission to the AER Draft
Determination and TransGrid revised 2018-23
regulatory proposal**

12 January 2018

Introduction

The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon disadvantaged and marginalised people. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training.

Our work addresses issues such as:

- access to affordable, sustainable energy and water services;
- homelessness;
- access for people with disability to basic services like public transport, education and online services;
- Indigenous disadvantage;
- discrimination against people with mental health conditions;
- the exercise of police power;
- the rights of people in detention, including the right to proper medical care; and
- government accountability, including freedom of information.

PIAC is funded from a variety of sources. Core funding is provided by the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from the NSW Government for its Energy and Water Consumers Advocacy Program and from private law firm Allens for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, donations and recovery of costs in legal actions.

Energy and Water Consumers' Advocacy Program

The Energy + Water Consumers' Advocacy Program (EWCAP) represents the interests of low-income and other residential consumers of electricity, gas and water in New South Wales, developing policy and advocating in energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- Ethnic Communities Council NSW;
- Salvation Army;
- St Vincent de Paul Society NSW;
- Physical Disability Council NSW;
- Anglicare;
- Good Shepherd Microfinance;
- Financial Rights Legal Centre;
- Affiliated Residential Park Residents Association;
- Tenants Union; and
- Mission Australia.

AER draft determination and TransGrid revised proposal

PIAC welcomes the opportunity to comment on the AER's draft determination for TransGrid's 2018-23 regulatory control period and TransGrid's revised proposal for that period.¹

PIAC welcomes the agreement on some key issues by the AER and TransGrid as reflected in the draft determination and revised proposal, particularly on opex rate of return and the value of imputation credits.

TransGrid's regulatory determination process comes when many NSW consumers are finding it difficult to pay their energy bills. Over the last ten years, the price of electricity has approximately doubled in NSW, with distribution network costs driving this increase.² This was compounded by the wholesale cost-driven July 2017 retail price increases felt across them NEM.

In this climate, it is critical that consumers pay no more than is necessary for energy services. TransGrid's allowed revenue for the 2018-23 period should be absolutely no higher than is efficient to deliver these services.

PIAC wishes to provide comment on the following issues:

- TransGrid's consumer engagement;
- Consumer risk and uncertainty;
- TransGrid's proposed Power Sydney's Future (PSF) project;
- TransGrid's proposed replacement expenditure;
- TransGrid's proposed renewable energy zone contingent projects; and
- TransGrid's proposed rate of return.

In addition, PIAC supports the Energy Consumers Australia's (ECA) submission to this process and notes ECA's expert report by JWH Consulting, which is referred to throughout our submission.³

TransGrid's consumer engagement

PIAC considers good consumer engagement to be a core aspect of the regulatory process for network service providers (NSPs) and essential to ensure that outcomes reflect consumer needs and preferences. By engaging with consumers and their advocates, NSPs can meaningfully consider the views of the consumers they serve, and reflect these views in regulatory proposals.

¹ AER, Draft decision: TransGrid transmission determination 2018-23, Overview, September 2017, <<https://www.aer.gov.au/system/files/AER%20-%20Draft%20decision%20TransGrid%20transmission%20determination%20-%20Overview%20-%2028%20September%202017.pdf>>; TransGrid, Revised Revenue Proposal, 2018/19 – 2022/23, December 2017, <<https://www.aer.gov.au/system/files/TransGrid%20-%20Revised%20Revenue%20Proposal%20-%201%20December%202017.pdf>>.

² ACCC, Retail Electricity Pricing Inquiry Preliminary Report, 2017, 12, <<https://www.accc.gov.au/publications/accc-retail-electricity-pricing-inquiry-preliminary-report>>.

³ Energy Consumers Australia, *Submission to AER Draft Determination and TransGrid Revised Proposal for the 2018-23 regulatory period*, January 2018; JWH Consulting, *Advice on the Capex Portion of the AER's Revenue Determination for TransGrid*, January 2018.

The AER outlines the best practice consumer engagement principles it expects NSPs to adhere to in its guideline.⁴ These are:

- Clear, accurate and timely communication;
- Accessible and inclusive engagement;
- Transparent engagement; and
- Measurable engagement.

TransGrid engaged with PIAC extensively as they prepared their revised proposal. This engagement has been conducted through bilateral meetings with TransGrid and as part of TransGrid's Revenue Proposal Working Group (RPWG). Through this engagement, PIAC has been able to consider how TransGrid performed against the AER's engagement principles.

In general, PIAC considers this to have been a positive process. PIAC has found senior TransGrid staff to be available and willing to transparently provide timely information to consumer advocates. Furthermore, the quality of information provided through the RPWG and other meetings has consistently been of a high quality; clear, accurate and accessible. TransGrid provided information on PIAC's request and generally engaged with consumer advocates on terms that suited them.

PIAC considers that there has been a measurable impact of consumer engagement on TransGrid's revised proposal. Following feedback provided through the RPWG, TransGrid agreed to revise aspects of its rate of return proposal and agreed to accept the AER's draft decision on rate of return and the value of imputation credits. PIAC considers this to be a good example of genuine, responsive consumer engagement.

Page 23 to 25 of TransGrid's revised proposal lists the feedback they received from the RPWG and the actions taken in response to each item raised. PIAC supports this format as a means of measuring consumer engagement impact.

While TransGrid's list is mostly accurate, PIAC notes the statements:

- 'RPWG questioned on what basis the AER rejected the need for Power Sydney's Future and put to TransGrid that the AER must come up with alternative triggers and project timings if it does not accept the project as proposed by TransGrid';⁵
- 'RPWG commented that AER's decision on Power Sydney's Future showed a different appetite for risk than TransGrid. RPWG stated that AER should declare the level of risk it feels is reasonable for a project such as Powering Sydney's future, to provide clarity over the decision-making process';⁶ and

⁴ AER, Consumer Engagement Guideline for Network Service Providers, November 2013, <<https://www.aer.gov.au/system/files/AER%20-%20Consumer%20engagement%20guideline%20for%20network%20service%20providers%20-%20November%202013.pdf>>.

⁵ TransGrid, Revised Revenue Proposal, 2018/19 – 2022/23, 2017, 24.

⁶ Ibid.

- ‘RPWG wanted to understand the differences between TransGrid’s and the AER’s approach to WACC. There was uncertainty as to whether the AER had been consistent with its own guidelines’.⁷

In PIAC’s view, these statements are only partly accurate. While the RPWG did discuss the AER’s and TransGrid’s views on PSF triggers, PSF risk and rate of return, the framing in the revised proposal suggest the RPWG were in uniform agreement and support of the TransGrid positions. The RPWG did not agree unanimously that the AER should be responsible for alternative triggers and project timings for PSF, nor that it was their responsibility for declaring their risk appetite. In both cases, RPWG members suggested that TransGrid and the AER should engage in open dialogue to develop mutually acceptable decisions. Finally, the ‘uncertainty as to whether the AER had been consistent with its own guidelines’ with regards to WACC was voiced mostly by TransGrid, not RPWG members.

PIAC considers consumer engagement to be a process of continuous improvement. PIAC would encourage TransGrid to engage directly with small consumers in the future. While consumer advocates can provide a consumer perspective on complex regulatory issues that layperson could not, this is no replacement for engaging with end use consumers. In the future, TransGrid should use deliberative processes to seek principles-based feedback from small consumers on matters that impact the transmission component of their electricity bill.

Consumer risk and the uncertainty

How NSPs choose to deal with risk and uncertainty is, inherently, a trade-off for consumers. While increased capital spend by an NSP may reduce the risk of outages for consumers, it will also lead to higher bills. It is in consumers’ interests for particular investments to be undertaken only when the risk of not investing truly outweighs the cost of proceeding.

PIAC is concerned that there is a tendency to over-value reliability, in some cases resulting in attempts to guarantee supply of electricity no matter the cost to consumers. In recent submissions, PIAC has commented on this trend across both the wholesale and network segments of the electricity supply chain.⁸ Expensive network investment in higher reliability only be made if the NSP can demonstrate they will bring commensurate benefit to consumers.

To this end, probabilistic risk assessments with credible value of customer reliability and risk assessment should be used when determining if network investment should proceed. Such assessments allow NSPs to assess the probability and consequence of asset failure, and compare that to the cost of addressing it through an investment. While this does not remove all uncertainty from the decision, it provides a framework through which NSPs and the AER can assess the risks faced by consumers if they do not proceed with a particular project.

⁷ Ibid, 25.

⁸ PIAC, *Affordable and efficient, or overpriced and underwhelming 2.0? Options for the future energy market: PIAC submission to ACCC Preliminary Report*, November 2017, 9-14, <https://www.accc.gov.au/system/files/Public%20Interest%20Advocacy%20Centre_0.pdf>; PIAC, *But what’s the USE?: Submission to AEMC Reliability Frameworks Review Issues Paper*, September 2017, 5-6, <<http://www.aemc.gov.au/getattachment/62f49dd8-789c-4417-8241-9e1c7e99d5eb/Public-Interest-Advocacy-Centre.aspx>>.

PIAC is satisfied that TransGrid used an investment assessment approach that takes into account probability and consequence of events, and monetises risk in order to develop a cost-benefit analysis for individual projects.⁹

However, the accuracy of this process relies on credible inputs and assumptions. PIAC notes that the JWH report, as well as the AER and their consultants (EMCa), consider that TransGrid has consistently overestimated both the likelihood and consequence of risks associated with not investing in the network.¹⁰ Doing so is likely to have overstated the benefit of capital investment in the network assets that consumers will pay for.

In response to criticism from the AER and EMCa, TransGrid stated that both organisations misunderstood TransGrid's methodology.¹¹ However, the JWH report suggests that this was not the case and that concerns about overestimating risk were reasonable.¹²

PIAC supports this suggestion and is of the view that TransGrid's revised proposal overstates the likelihood and consequence of risk, particularly in relation to PSF.

Power Sydney's Future

PSF is a major part of TransGrid's revised proposal, accounting for \$252m of the total \$1,534m forecast capex for 2018-23.¹³ PIAC notes that TransGrid has engaged extensively with stakeholders as they have planned for PSF.

In PIAC's view, PSF will be necessary at some point in the future.

A decision about the timing and scope of PSF presents a trade-off between two risks. Using their probabilistic investment assessment, TransGrid argues that both the probability and consequence of asset failure in Inner Sydney and the CBD mean that the project should begin immediately. Some transmission asset failures in the centre of Sydney are a considerable risk.

However, the other risk is that inefficient network investment is made, saddling consumers with higher transmission charges for the life of the assets. Making network augmentation only when benefits exceed costs keeps assets out of the regulatory asset base until they are truly needed. Furthermore, the pace of technological and commercial change means that new energy efficiency and other demand management techniques may be able to provide better non-network alternatives to meet the network need. This could provide opportunities to defer network augmentation even further or avoid it altogether.

The discussion around the timing and scope of PSF is underpinned by a number of key drivers of the project.¹⁴ Given the competing claims of TransGrid and the AER, PIAC considers that fundamental issues like demand forecasting, cable availability and sensitivity analyses remain

⁹ TransGrid, Revised Revenue Proposal, 2018/19 – 2022/23, 2017, 63-69.

¹⁰ JWH Consulting, *Advice on the Capex Portion of the AER's Revenue Determination for TransGrid*, 2018, 4.

¹¹ TransGrid, Revised Revenue Proposal, 2018/19 – 2022/23, 2017, 70.

¹² JWH Consulting, *Advice on the Capex Portion of the AER's Revenue Determination for TransGrid*, 2018, 4.

¹³ TransGrid, Revised Revenue Proposal, 2018/19 – 2022/23, 2017, 41.

¹⁴ TransGrid, Revised Revenue Proposal, 2018/19 – 2022/23, 2017, 52.

highly uncertain. Therefore, the optimal timing and scope of the project as a whole remains uncertain.

In PIAC's view, the risk that implementing PSF in the coming regulatory period will result in inefficient network investment is too high. PIAC contends that it is appropriate for consumers and TransGrid to assume some risk of asset failure where there is considerable uncertainty about whether particular network investments are in the long-term interests of consumers.

TransGrid has argued to PIAC that any delay in starting PSF will mean that the construction timeline will have to be shortened, adding cost to the project. However, as the drivers of the project are still contested, this is not necessarily true. If the AER and JWH concerns prove to be justified, starting PSF after the 2018-23 regulatory period would not result in a condensed construction timeline. If the project does not need to be completed until later, TransGrid could take the same amount of time with a later start date.

TransGrid has indicated that delaying PSF could increase its cost because construction labour and plant will be in higher demand (and therefore more expensive) due to increased construction activity in Inner Sydney and the CBD. This brings into question whether or not the project would pass an investment assessment at that point.

Given the uncertainty about the optimal timing and scope for PSF, PIAC contends the risk to supply noted by TransGrid do not currently outweigh the cost to consumers of potentially overbuilding the network. For this reason, PIAC considers it prudent for PSF to be implemented at some later date, either through a contingent project or inclusion in the capex allowance for a subsequent regulatory period.

Replacement expenditure

PIAC supports TransGrid's use of a probabilistic, condition-based model for asset management over less responsive and more deterministic options such as an age-based model. In general, condition-based models provide a more accurate assessment of the risk of failure of a particular asset and help drive more efficient operation, maintenance and planning of the network.

While TransGrid has raised concerns about the AER's understanding of its asset management model, ECA's expert analysis from JWH consulting examining the disputed capex matters and supports the AER's draft determination. In particular it concludes that the AER and EMCa have appropriately understood TransGrid's risk modelling process. Further it finds that, despite the EMCa report containing some factual errors as pointed out by TransGrid, these errors are not material to change the validity of the AER's conclusions.¹⁵

PIAC supports the AER's review of TransGrid's replacement to ensure it is efficient and prudent, and emphasises the import of this given the age of many assets in electricity networks and the increasing proportion of replacement expenditure in revenue allowances.

¹⁵ JWH Consulting, *Advice on the Capex Portion of the AER's Revenue Determination for TransGrid*, 2018, 4.

Allowance for RIT-T for repex

TransGrid requested an allowance for conducting Regulatory Investment Test for Transmission (RIT-T) for replacement expenditure, stating that “in the absence of a regulatory requirement, a prudent business would not choose to undertake a process which adds substantial cost and almost a year to the investment pathway.”¹⁶

While conducting a RIT-T for replacement projects does impose obligations on a TNSP, many of these, such as conducting cost-benefit and sensitivity analyses, should be part of good business practice anyway. Therefore, any allowance provided for conducting RIT-T for replacement projects must only be for efficiently meeting obligations which impose material costs *in addition to* standard business practice.

Renewable energy integration projects

Emissions reduction is essential across the Australian economy. The electricity sector is well placed to achieve significant emissions reductions in a timely and cost-effective manner given the range of low emission generation technologies such as wind and solar which are already commercially viable and other technologies reaching this stage.

Transmission and businesses can play an important role in ensuring that this transition occurs efficiently. However, the benefits of an accelerated transition to a low emissions sector must be balanced against the risk of saddling consumers with inefficient investments.

PIAC generally supports TransGrid in using the contingent projects mechanism in such cases rather than in the ex-ante capex proposal, considering the level of uncertainty in the volume, timing and precise location of the new renewable energy connections then resulting in uncertainty in the impacts on the transmission network and the role the network may play in helping to facilitate these new connections.

However, when using a contingent project mechanism, determining appropriate trigger conditions is very important. On the one hand, the trigger must provide enough certainty that the project is prudent and inclusion in the regulatory allowance is in consumers’ long-term interest. On the other hand, the trigger must also provide the business with enough lead time to develop the most cost-effective solution.

PIAC generally supports TransGrid’s proposed trigger conditions, but is concerned they may in some cases allow it to proceed with a project without necessarily completing a RIT-T, or equivalent. This would not be an appropriate outcome.

PIAC recommends that the trigger conditions be amended such that the contingent projects must successfully pass a RIT-T, or equivalent test, *as well as* either:

- Being included in renewable energy zones in AEMO’s Integrated Grid Plan; or

¹⁶ TransGrid, Revised Revenue Proposal, 2018/19 – 2022/23, December 2017, 80.

- Being notified by Federal Government, the COAG Energy Council, NSW Government or the Energy Security Board that transmission augmentation is required to meet or manage expected demand for prescribed transmission services or associated regulatory obligation.

Rate of return and gamma

PIAC considers that the issues regarding the estimation of gamma has been thoroughly prosecuted and largely settled following the recent decisions of the Australian Competition Tribunal and Full Federal Court.

PIAC supports TransGrid for accepting the AER's draft determination regarding the rate of return and the value of imputation credits (gamma). This is especially welcome given of how contentious the rate of return and gamma has been in previous determinations.

Further engagement

PIAC would welcome the opportunity to discuss these issues in more depth. For any queries please contact:

- Policy Team Leader, Energy and water, Craig Memery at cmemery@piac.asn.au or on (02) 8898 6522; or
- Policy Officer, Energy and water, Tim Harrison at tharrison@piac.asn.au or on (02) 8898 6518.