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

Lodged via email: REZ@aer.gov.au

Dear Kami,

Revenue determination guideline for NSW non-contestable network infrastructure projects

Transgrid welcomes the opportunity to respond to the draft 'Revenue Determination Guideline for NSW non-contestable network infrastructure projects' published by the Australian Energy Regulator (AER) on 30 November 2022. We understand that the AER is preparing this document as part of the NSW Electricity Infrastructure Roadmap framework and that a final guideline will be published in early 2023.

Transgrid operates and manages the high voltage electricity transmission network in NSW and the ACT, connecting generators, distributors and major end users. We have an important role in managing one of the key parts of the Australian energy system as it transitions to higher renewables penetration, including carrying out elements of Priority Transmission Infrastructure Projects (PTIPs) and enabling, via network augmentation and connection, of Renewable Energy Zones (REZs).

Transgrid supports the development of the NSW Electricity Infrastructure Roadmap which will coordinate investment in transmission, generation, storage and firming infrastructure as ageing coal-fired generation plants retire.

Transgrid recognises the pivotal role that the AER will play in supporting the timely delivery of the transmission infrastructure required to deliver PTIPS and REZs in NSW. As such, we support the development of this guideline to provide Transgrid, and other stakeholders, with an understanding of how the AER will exercise its functions under Part 5 of the *NSW Electricity Infrastructure Investment Act 2020* (the EII Act) for non-contestable revenue determinations. It is critical that the NSW framework provides certainty to Network Operators as they embark on delivering the significant amount of transmission investment required for the energy transition.

We understand that in preparing this draft Guideline, the AER has used Chapter 6A of the National Electricity Rules (NER) as the basis for its assessment approach, with several differences to reflect that the AER's assessment under the EII Act is narrower than the scope of its assessment of a transmission network service provider's revenue proposal under the NER.

Transgrid offers feedback on six key areas outlined below to assist the AER in finalising this guideline.

We support early engagement by a Network Operator with stakeholders and the AER

The draft Guideline outlines that the AER expects a Network Operator to engage with stakeholders ahead of submitting a revenue proposal to the AER on the costs that it proposes to meet the requirements of the Consumer Trustee's authorisation or the Minister's authorisation or direction and invite public comment on the proposal.

We support early engagement by a Network Operator with stakeholders and the AER to ensure that expectations are as aligned as possible. Input from our customers and other stakeholders is critical to the development of our Revenue Proposals. Furthermore, ongoing dialogue with our customers and other stakeholders is essential to ensure we continue to provide services tailored to suit our customers and other stakeholders' needs in a rapidly changing energy system.

We agree with the AER that given the nature of these projects, a Network Operator's stakeholder consultation will be narrower than that of transmission network service providers under the NER, as the Consumer Trustee's authorisation or Minister's authorisation or direction will specify most aspects of the non-contestable project.

We note however that some scenarios may present challenges to early engagement including where the network augmentation covered by the non-contestable revenue proposal cannot be consulted on while an associated contestable procurement process is being conducted. We encourage the AER to consider acknowledging these scenarios as exceptions to the early engagement expectation in the Guideline.

We welcome further guidance from the AER on its expectations for engagement by a Network Operator with both the AER and other stakeholders during the pre-lodgement and revenue determination processes.

We support a timeframe that provides certainty to network operators, investors and all stakeholders

We note that the AER's proposed timeframe allows 126 business days (which is around six months) between the initial revenue proposal and the AER Final Decision. We support a six-month timeframe, which is considerably shorter than the NER Revenue Determination timeframes and therefore provides certainty for Network Operators, their investors and all other stakeholders in a shorter timeframe. However, we are very concerned about a Network Operator only having one month to prepare a revised revenue proposal in response to the AER's Draft Decision.

We do not consider that one month to prepare a revised revenue proposal in response to the AER's Draft Decision is a reasonable timeframe in which to adequately address any issues raised by the AER in its Draft Decision, issues raised by stakeholders and to enable the necessary internal governance and approvals. Consistent with the provisions under the NER, we suggest that a reasonable timeframe for preparing a revised revenue proposal following the AER's Draft Decision is 'not more than 45 business days'. This is the minimum timeframe that we consider would be achievable given internal governance as well as any changes to forecast costs and other elements that may be required based on updated information.

The AER should apply a fit-for-purpose approach for incentive schemes

We understand that only the expenditure incentives of the NER will apply under the NSW framework, as a separate and specific service target performance incentive scheme (STPIS) will be developed for the NSW framework and the small scale incentive scheme and demand management innovation allowance mechanism will not apply under the NSW framework.

Our preference is that the AER exempt projects carried out under the NSW framework from the Efficiency benefit sharing scheme (EBSS) and Capital expenditure sharing scheme (CESS) as there will be little or perhaps even no opportunity to reprioritise expenditure given the determination being considered will relate only to a single project. Despite our best efforts, we know that there will be unforeseeable and unquantifiable costs that will arise in the delivery of these projects which would mean that it will be difficult to outperform under these schemes. If these schemes were to be applied under the NSW framework, then we seek clarity from the AER that the CESS and EBSS would only apply from the second regulatory control period, in light of the overall risk associated with delivering them under the regulatory framework.

We would welcome the opportunity to engage with the AER as it develops the STPIS guideline applicable under the NSW framework, to ensure that the scheme is fit-for-purpose for network infrastructure projects carried out under the EII Act. Further, we support the AER's proposed approach that a NSW-specific version of the STPIS would apply to non-contestable determinations from the second regulatory control period.

Forecasting risks further heightened in current and foreseeable global socio-economic climate

Under the EII Act Regulations, Network Operators must submit revenue proposals setting out the amounts required to be paid for the following five years.[1] This means that a revenue proposal is to set out accurate forecasts for all project costs with no subsequent opportunity to adjust. Transgrid would like to highlight that accurately forecasting costs for a large infrastructure project five years ahead is challenging, particularly in the current socio-economic climate.

This is different to the staged approach to Contingent Projects under the NER, which allows staged Contingent Project Applications (CPAs) to enable more certainty in forecasting project costs. For example, early works costs are forecasted in a stage 1 CPA and remaining implementation costs are forecasted at a later point through a stage 2 CPA.

We note that the AER's draft Guideline sets out that a revenue proposal must include mechanisms to adjust the revenue proposed to be paid. We seek further clarity on how the AER will treat such mechanisms given that may reduce forecasting risks.

We would welcome engagement with the AER on this issue of forecasting risk prior to finalisation of the AER guidelines.

[1] See EII Regulation, s. 52.

Transgrid supports the inclusion of risk costs in the NSW framework

Transgrid supports the inclusion of the provisions for risk costs in the NSW framework.[2] We expect to seek to include these as relevant for individual projects during the revenue determination process, noting that the nature and scope of risk costs is likely to evolve during the process and therefore it will be important to take a flexible approach to risk costs.

Financeability remains a key concern for Transgrid

The longer-term solution to financeability via regulatory reform in the national framework remains a priority for Transgrid and we will continue to work with regulators, government and industry on a workable solution that solves for both timely investment and consumer benefits.

The AEMC is currently recommending that changes are made to the regulatory framework to support the financeability of ISP projects and the AEMC's proposed remedy is to amend the regulatory framework so that the AER has flexibility to change the depreciation profile on a case-by-case basis.

Unfortunately, these arrangements do not solve the issue and does not provide investors with the certainty they need to provide the significant amount of transmission investment required. This is because it leaves too much discretion to the AER as to how it will assess whether there is a financeability problem and the AER is not a rating agency or an investor, so the approach to assessing financeability must be codified to provide market certainty.

In addition, using the existing business as a starting point is challenging, given financeability is an issue which is relevant to all forms of capital, debt and equity. Each form of capital will undertake their own due diligence to assess the viability of investing. Certainty over the regulatory regime and outcomes, particularly returns, are important for attracting capital:

- Debt providers look to rating agencies who apply their qualitative assessment to various aspects of the company's actual circumstances including, for example, the extent of its non-regulated activities and the performance of its management team. The AER cannot replicate the work of the agencies to make any assessment of rating outcomes, or timeframe over which they will occur.
- A forecast corporate model contains many subjective assumptions. Understanding how equity consider the future will be paramount when assessing financeability, and this assessment may be challenging for those outside the business.
- The viability of any new project must be assessed on a stand-alone basis so as not to contaminate the returns allocated to prior projects or the broader business.

In its draft Guideline the AER states:

[2] See clause 50A(e) of *Electricity Infrastructure Investment Amendment (Non-Contestable Revenue Determinations) Regulation 2022*

"This Regulation permits us to adjust depreciation if it we consider that *there is merit in doing it on a whole of business basis assessing, amongst other things, key financial metrics."*

Our view is that the AER should not pre-empt an approach under the NSW framework while the national arrangements are still being settled. This is particularly important given the NSW framework relies heavily on Chapter 6A of the national framework.

Transgrid wishes to engage with the AER on this issue prior to the finalisation of these AER guidelines.

We appreciate the opportunity to provide feedback on this important guideline, and we will continue to work collaboratively with the AER on its ongoing development and other key elements of the revenue determination process to support the NSW Roadmap framework. If you require any further information or clarification on this submission, please feel free to contact me or Stephanie McDougall at [redacted].

Yours faithfully

[redacted]

Maryanne Graham
Executive General Manager
Corporate & Stakeholder Affairs