

11 January 2018

Ms Paula Conboy  
Chair  
Australian Energy Regulator

By email: TransGrid2018@aer.gov.au

## **Submission to AER Draft Determination and TransGrid Revised Proposal for the 2018-23 regulatory period**

Dear Ms Conboy,

Energy Consumers Australia (ECA) welcomes the opportunity to make a submission on the Australian Energy Regulator's (AER) Draft Determination and TransGrid's Revised Proposal for the determination of TransGrid's allowed revenue for the regulatory control period 1 July 2018 to 30 June 2023.

In summary, while ECA is heartened by Transgrid's greater engagement with consumer representatives and agrees with many of the key components of Transgrid's Revised Proposal, it disagrees with Transgrid's proposed allowance for capital expenditure. Accordingly, the capex proposal is addressed in detail under headings 3.3 and 3.4 below.

### **1. Our objective and aim in this process**

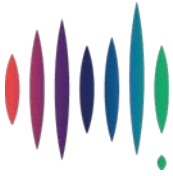
ECA was established in 2015 as an initiative of the Council of Australian Governments (COAG) Energy Council, and its predecessor the Standing Council on Energy and Resources (SCER). ECA was registered on 29 January 2015 as a company limited by guarantee, and is governed by a [constitution](#). ECA's sole member is the South Australian Minister of Energy on behalf of each member of the COAG Energy Council.

Clause 4.1(a) of ECA's constitution provides that ECA's object is:

*To promote the long term interests of Consumers of Energy with respect to the price, quality, safety, reliability and security of supply of Energy services by providing and enabling strong, coordinated, collegiate evidence based consumer advocacy on National Energy Market matters of strategic importance or material consequence for Energy Consumers, in particular for Residential Customers and Small Business Customers.*

Clause 4.2 of ECA's Constitution provides that ECA will seek to achieve its objects through a number of activities, including "participating in National Energy Market issues and influencing regulatory activities and Energy market reform to benefit Consumers." Additional information about ECA is provided at **Attachment 2**.

In participating in energy network revenue determinations, such as the current TransGrid process, ECA is seeking to ensure that current and future consumers are not required to pay a single dollar more than is necessary to receive the services they require.



This is also the intent of the National Electricity Objective (NEO), which guides the AER in making its final revenue determinations.

## 2. The context of this determination

In the last ten years the price of electricity has approximately doubled in New South Wales (NSW), with network costs being the principal contributor.<sup>1</sup>

Households and small businesses are now facing a further round of price increases, this time caused by higher wholesale costs.<sup>2</sup> The latest St Vincent de Paul Tariff Tracker Report for NSW indicates that the standing offers taking effect from 1 July 2017 would increase typical annual household bills by 15-20 per cent (\$325-\$450) compared to the preceding 12-month period.<sup>3</sup>

This combination of significant increases over time, and more recent price spikes, is causing what the Australian Competition and Consumer Commission (ACCC) recently characterised as a “severe electricity affordability problem” in New South Wales and across the NEM.<sup>4</sup>

Consistent with the NEO, this critical affordability context must be core to any assessment of network expenditure and investments going forward. Now more than ever, there is a need for network businesses, the AER and other stakeholders to forensically scrutinise augmentation and asset management plans, and to consider alternative ‘non-network’ solutions, to ensure that consumers are not required to spend a dollar more than is necessary to get the energy services they need.

As we explain in detail in this submission, expert advice we commissioned to inform our contribution to this process indicates that Transgrid has over-estimated the reliability risks facing the network and the AER’s assessment of its capex plans in the 2018-2023 period should stand.

Efforts are being made across the sector to ‘turn the page’ and develop more productive and collaborative processes for developing network revenue allowances that best promote the long-term interest of consumers. As you know, we are also currently working with the AER and Energy Networks Australia (ENA) on a new, more flexible and deliberative process to develop revenue proposals.<sup>5</sup>

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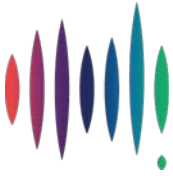
<sup>1</sup> Australian Competition and Consumer Commission (ACCC) 2017, *Retail Electricity Pricing Inquiry Preliminary Report*, <https://www.accc.gov.au/publications/accc-retail-electricity-pricing-inquiry-preliminary-report>, p 12 (Figure 1.2).

<sup>2</sup> Australian Energy Market Commission (AEMC) 2017, *2017 Retail Electricity Price Trends*, <http://www.aemc.gov.au/Markets-Reviews-Advice/2017-Residential-Electricity-Price-Trends>, p V (Figure 2).

<sup>3</sup> St Vincent de Paul Society, *NSW Energy Prices July 2017 – An update report on the NSW Tariff-Tracking Project*, [https://www.vinnies.org.au/icms\\_docs/272193\\_NSW\\_Energy\\_Prices\\_July\\_2017.pdf](https://www.vinnies.org.au/icms_docs/272193_NSW_Energy_Prices_July_2017.pdf), p 6.

<sup>4</sup> Australian Competition and Consumer Commission (ACCC), 2017, *Retail Electricity Pricing Inquiry Preliminary Report*, <https://www.accc.gov.au/publications/accc-retail-electricity-pricing-inquiry-preliminary-report>, p 5.

<sup>5</sup> See ECA, *Working together to improve engagement in network revenue proposals*, <http://energyconsumersaustralia.com.au/news/working-together-improve-engagement-network-revenue-proposals/>



The current intention amongst the three groups is to commence formal public consultation on this new approach in the first quarter of 2018 and I am heartened by the progress of the collaboration.

### 3. The current process

#### 3.1 Our involvement in the current TransGrid process

ECA has engaged in the current determination process as a member of TransGrid's Advisory Council (TAC) and has also participated in the Revenue Proposal Working Group (RPWG).

In addition, ECA participated in the AER's Draft Determination Forum, on 10 October 2017. We have also engaged directly with TransGrid's senior management team in relation to specific aspects of the revenue proposal, and attended meetings about *Powering Sydney's Future* (PSF). Finally, there have been extensive discussions and correspondence between ECA staff, including myself, and senior TransGrid staff in relation to aspects of the revenue determination process.

We would like to acknowledge TransGrid's responsiveness and willingness to engage through this process and in particular the opportunity to comment on the initial and revised proposals. TransGrid's decision to revise its approach to aspects of the rate of return (discussed further below), following feedback provided at the RPWG meeting on 26 October 2017, is good for consumers and demonstrative of the 'you said, we acted' approach that underpins genuine consumer engagement.

#### 3.2 Areas of agreement

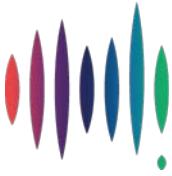
TransGrid and the AER are effectively in agreement about many of the key components of the revenue determination. The AER's Draft Determination permitted TransGrid \$3,910m, an 8.4% reduction on TransGrid's proposed allowance of \$4,269m. The AER permitted TransGrid, 92% of its proposed operating expenditure, rejecting \$74.7m of TransGrid's proposed \$947.7m allowance.<sup>6</sup> Both the AER and TransGrid acknowledged the significant areas of agreement at the 10 October 2017 public forum.

ECA welcomes TransGrid's revised proposal in relation to the weighted average cost of capital (WACC) and value of tax imputation credits (Gamma). We note, however, that TransGrid still 'leaves a stake in the ground' regarding possible other values for these two parameters.<sup>7</sup> As alluded to above, the RPWG was offered the opportunity to provide feedback on well-developed draft revised propositions for these parameters before the issues were settled by the TransGrid Board. This is a positive and constructive practice but is not yet standard practice across all network businesses. Accordingly, ECA commends TransGrid both on its decision to adopt the AER's Draft Determination for WACC and Gamma and the way consumers were given the opportunity to provide comment on these issues.

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<sup>6</sup> AER, *Draft Decision: TransGrid transmission determination 2018 to 2020: Overview*, p 29

<sup>7</sup> On page 13 of its Revised Revenue Proposal, TransGrid notes arguments supporting a higher market risk premium based on 'current market evidence' and a lower Gamma "using the ATO Tax statistics method without reliance on assumptions or adjustments."



### 3.3 Area of disagreement – capex

The one area of significant disagreement between the AER and TransGrid is capital expenditure (capex). The AER rejected 39% of TransGrid's proposed capex allowance, permitted \$992m against TransGrid's request for \$1,638m.<sup>8</sup> The AER completely rejected the large PSF project, worth more than \$330m. While TransGrid has developed an alternative proposal that would cost \$251m, the overall revised capex proposal is just below the initial proposal, at \$1,534m.

ECA commissioned JWH Consulting (John Howarth) to provide expert advice on the disputed capex matters. In developing this advice, John Howarth, has considered the AER Draft Determination and the supporting expert report by EMCa, as well as TransGrid's revised proposal.

His report (included as **Attachment 1**) concludes that, for a variety of reasons, "the Draft Determination by the AER [is] the better estimate of the forecast capex that should be sufficient for a prudent and efficient service provider in TransGrid's circumstances".<sup>9</sup>

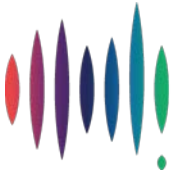
More specifically, in the opinion of ECA's expert:

- Despite TransGrid's assertions, the AER and EMCa do understand TransGrid's risk modelling process and have not misinterpreted the information. Further, it was reasonable for the AER to conclude that TransGrid have overstated the risk or demonstrated a bias towards overstating the risk generally.
- As asserted by TransGrid, there do appear to be factual errors in the EMCa report (e.g. chart on page 40) but it is impossible to ascertain the correct position because the information requests and responses have not been made publicly available. However, these errors are not material in that they do not fundamentally change the validity of the reasoning that underpins the majority of the AER's capex reductions (see section 3.4, below).
- In relation to demand driven capex, TransGrid has not adequately responded to the issues that the AER raised in relation to the probability of connections and the analysis of options.
- TransGrid should assess reliability requirements on a connection point basis, and the option of applying for a new reliability standard for the Molong and Mudgee substations should be considered.
- In relation to PSF, a delay of five further years is appropriate, even for the single cable option.

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<sup>8</sup> AER, as above n 8, p 26.

<sup>9</sup> Attachment 1 to this submission, p 12.



### 3.4 Errors in the EMCa report

There is a need to resolve the matter of the ‘factual errors’ TransGrid identifies in the EMCa report.<sup>10</sup> In its Revised Proposal, TransGrid states that:

*We appreciated the opportunity to fact-check Energy Market Consulting Associates’ (EMCa) draft report. Despite notifying the AER of more than thirty factual and interpretative errors, the unchanged report was published without any indication that corrections could be required. Many of the most significant errors form the basis of the draft decision - especially the examples where risk consequence costs have been misinterpreted.*

The JWH report concludes that while these errors do appear to exist, they “do not fundamentally change the arguments on which the majority of the capex reductions were made by the AER”.<sup>11</sup> Nonetheless, ECA notes that this is an example of a circumstance which ongoing dialogue between the AER, networks and consumers could have resolved before the publication of the Draft Determination. ECA acknowledges, however, that the complexity of the determination process imposes limitations on all participants, including the AER.

Accordingly, ECA requests that the AER deal with these matters in its Final Determination, or before. If similar future circumstances arise, ECA also encourages the AER to consider whether it might be possible to issue a supplementary correction or discussion document, prior to the Draft Determination, to assist stakeholders in commenting on the issues.

Notwithstanding that issue, and on the basis of the expert advice attached, our view is that the AER’s Draft Determination and the conclusions it reaches on the disputed capex matters, are valid, and the AER can reasonably be satisfied that they are likely to contribute to the achievement of the NEO to the greatest degree, as required by s 16(1)(d) of the National Electricity Law.

If anyone at the AER would like to discuss this matter further, please contact Oliver Derum on (02) 9220 5514 or [oliver.derum@energyconsumersaustralia.com.au](mailto:oliver.derum@energyconsumersaustralia.com.au).

Yours sincerely

Rosemary Sinclair  
Chief Executive Officer

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<sup>10</sup> Transgrid, *Revised Revenue Proposal 2018/19 – 2022/23*, p 38

<sup>11</sup> Attachment 1 to this submission, section 5.1.2, (p 5).