Public Interest Advocacy Centre

24 November 2024

Kami Kaur
General Manger
NSW REZ Branch
Australian Energy Regulator
GPO Box 1313
Canberra ACT 2601
By email: REZ@aer.gov.au

Dear Ms Kaur,

Draft decision (non-contestable) – Transgrid – Waratah Super Battery 2024-29

The Public Interest Advocacy Centre (PIAC) welcomes the opportunity to respond to the Australian Energy Regulator's (AER) draft decision on the Waratah Super Battery (the draft decision).

PIAC does not support Transgrid's proposal to waive the Capital Expenditure Sharing Scheme (CESS) for the Waratah Super Battery (WSB). The risk of the decision forming a precedent and undermining a key pillar of consumer protection in the transmission investment regulatory regime is substantial. On the other hand, the possibility of an underspend - and potential for benefit to consumers - is very small. The substantial risks far outweigh any potential benefits to consumers in this scenario.

We are aware that Transgrid proposes waiving the Efficiency Benefit Sharing Scheme (EBSS) for the project as well as the CESS. We support the AER's position in the draft decision to wait until the end of the first regulatory period to make a decision on applying the EBSS due to the absence of any historical opex on which to base forecasts.

The CESS is an important protection for consumer interest

The CESS is a key protection for consumers in a principal-agent relationship with transmission service providers often defined by information asymmetry. It functions alongside the ex-poste review, but does not suffer from the same limitations of the latter.

The ex-poste review has practical limitations in the protection it affords. It is difficult for the AER to establish with strong confidence how a different course of action taken by the transmission service provider would have been more efficient, as it is necessarily dealing with a counterfactual. As a result, the AER has historically been loath to impose any costs on transmission providers using the ex poste review.

WSB is a unique project, but that does not imply the CESS is not appropriate
PIAC accepts that there are circumstances that make the WSB project unique and limits Transgrid's capacity to manage associated costs at this stage.Transgrid was required by Ministerial Order to deliver the project, and the design and procurement stages were, by necessity, run in parallel to one another. These are important extenuating circumstances. But these circumstances do not mean that:

- Transgrid has had, and has no capacity to manage the costs of the project; or
- Transgrid is not better positioned than consumers to manage the costs of the project; or
- The primary consumer protection is not needed.

Transgrid is well-compensated for any risks it bears as the monopoly provider of transmission services in NSW. These risks should not be seen on a project-by-project basis, but across the full portfolio of investments that Transgrid has.

Transgrid has in recent years returned profits above the level implied by the regulated rate of return.[1] Whether due to the regulator's intentional application of efficiency-enhancing incentives or from windfall profits, it is natural that there are occasions on which the profits may fall below, as well as exceed expected levels. WSB is a very small project in the context of Transgrid's portfolio. The possibility that increased costs for the project borne, in part, by Transgrid, does not threaten the highly profitable position that Transgrid occupies, taking a portfolio-wide perspective, or suggest that the regulatory structures are not working as intended.

As the AER has noted in its draft determination, Transgrid is having its exposure to cost escalation risk reduced via the application of the adjustment mechanism (the cost pass through provision). The purpose of this provision is to manage unavoidable contract variations, and this is what it is being used for here. There is no need to adjust the regulatory settings further in order to manage the situation.

The 'unquantifiability' of the risks associated with the Waratah Super Battery does not impact the appropriateness of the regulatory structures in any way. If Transgrid is only able to bear risks that are quantifiable, there is a need to reassess the compensation Transgrid has received in recent years, and consider which revenue related to quantifiable and unquantifiable risks, and to return to consumers those that relate to the latter.

The value of consumer protection does not exist only in relation to quantifiable risks. Consumers already bear 70% of the risk of an overspend. It is reasonable that the project proponent would bear some risk in the project, here as with any other project. Additionally, in this case, Transgrid had ample opportunity while negotiating with the NSW Government over the terms of the project, to manage risk, even if further opportunities have been limited since commencement.

[1] IEEFA, 2023, Power prices can be fairer and more affordable.

The AER should not protect EnergyCo from agreements it has entered into

PIAC does not believe it is the AER's responsibility to shelter the NSW Government or its proxies from the implications of decisions it has made. EnergyCo has agreed to cover Transgrid's share of an overspend using consumers' money. In doing so they have undermined the regulatory structures intended to incentivise Transgrid to provide the project as efficiently as possible. This side agreement should not be taken into consideration by the regulator when making the determination. It is the responsibility of the NSW Government (and EnergyCo) to determine the degree to which this agreement will impact NSW Consumers. The AER should seek to apply its own regulatory framework consistently.

The agreement between Transgrid and EnergyCo makes the AER's decision largely immaterial for Transgrid, except in the event of an underspend, which it believes is unlikely. In the consultation process, the question of materiality has been framed in relation to consumers. The AER has suggested that given the impact of waiving the CESS is immaterial to consumers in the event of an overspend, perhaps they should be more open to considering it. We consider the question more pertinent for Transgrid: why does Transgrid want to waive the CESS under these circumstances? In the event of an overspend they bear no extra cost and in the event of an underspend they forego their 30% share of the savings. The most apparent justification is that the decision is viewed within a larger program of weakening consumer protection by altering the balance of risks transmission service providers and consumers bear. The only benefit Transgrid gains from the CESS being waived in this case is directly at the expense of the robustness of ongoing protection to consumers. We do not support the proposal on this basis.

We welcome the opportunity to meet with the AEMC and other stakeholders to discuss these issues in more depth. Please contact me at mlynch@piac.asn.au regarding any further follow up.

Yours sincerely

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