AER Capital Expenditure Incentive Guideline Review 2025

APA Submission

March 2025

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Lodged by email: aerinquiry@aer.gov.au

21 March 2025

RE: APA Submission to the AER Capital Expenditure Incentive Guideline Review

Dear Mr Gulbenkoglu,

Thank you for the opportunity to comment on the AER's Capital Expenditure Incentive Guideline (the Guideline) Review Consultation Paper (Consultation Paper).

APA is an Australian Securities Exchange (ASX) listed owner, operator, and developer of energy infrastructure assets across Australia. As well as an extensive network of natural gas pipelines, we own or have interests in gas storage and generation facilities, electricity transmission networks, renewable generation and battery infrastructure.

APA is the part owner and operator of two Transmission Network Service Providers (TNSPs) in the National Electricity Market (NEM):

- Murraylink, a high voltage electricity transmission asset which delivers electricity between the South Australian and Victorian regions of the NEM
- Directlink, a high voltage electricity transmission asset which delivers electricity between the New South Wales and Queensland regions of the NEM.

As TNSPs, both Murraylink and Directlink are regulated by the AER under the National Electricity Rules and Law. The Capital Expenditure Sharing Scheme (CESS) currently applies to both Murraylink and Directlink.

The main focus of the Consultation Paper is the introduction of separate, targeted ex-post reviews for Integrated System Plan (ISP) project expenditure, and how to undertake those reviews across multiple regulatory control periods.

The Consultation Paper is also seeking views on whether the AER should broaden the scope of exclusions in the CESS in certain circumstances. Based on our experience, efficient spend on replacement capital expenditure projects for non-ISP projects has been penalised under the CESS. We believe this warrants further consideration. To support this, we suggest that the Guideline include additional exclusions, as demonstrated in the case study below.

Case study: penalising efficient replacement expenditure

Insulated Gate Bi-Polar Transistors (IGBTs) are the key component of Directlink's High Voltage Direct Current (HVDC) converter stations. Directlink has over 5,000 IGBTs in

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service. In October 2018, ABB, the single provider of IGBTs, advised that it was discontinuing support for the legacy Generation One IGBTs used by Directlink.

APA considered various options to address the obsolescence of Generation One IGBTs. The preferred option, which was approved by the AER in its June 2020 Final Decision, was to enter into a new, long term replacement IGBT contract with ABB. The AER considered the contract commencement date of January 2021 as reasonable and approved a capital expenditure forecast of $15.6 million for this project.[1]

In 2021, after the AER's Final Decision, ABB indicated that it was unwilling to sign such a contract. This meant that the only available option was to undertake a single system replacement, the cost of which was $17 million, higher than the $15.6 million approved in June 2020.

In its January 2024 revenue proposal for 2025-30, Directlink proposed that this capital expenditure overspend be excluded from the application of the CESS. Directlink did so on the basis that not doing so would have negative impacts on customers.[2] In its September 2024 draft decision, the AER did not accept this approach, suggesting that the Guideline does not provide for capital expenditure to be excluded ex-post on the basis proposed by Directlink.[3]

The Guideline should accommodate CESS exclusions

As outlined in Directlink's January 2024 revenue proposal, we maintain the view that the Guideline should accommodate exclusions in the CESS. Directlink's proposed approach to address the obsolescence of Generation One IGBTs was approved by the AER. Due to circumstances beyond Directlink's control, that solution became unavailable. The operation of the current Guideline results in penalties for Directlink's additional expenditure that was not due to 'inefficiency' on Directlink's behalf. Such an outcome negatively impacts consumers in two ways:

- it discourages TNSPs from pursuing innovative solutions that are in customers' long term interests
- it incentivises TNSPs to 'lock down' the costs of major expenditure at the time of a revenue proposal, rather than when a project is being undertaken.

Clause 6.5.8A of the National Electricity Rules requires that the CESS be developed in a way that rewards or penalises improvements or declines in the efficiency of capital expenditure.[4] We do not consider that penalising a service provider for capital expenditure overspends that were demonstrably outside its control to be consistent with clause 6.5.8A. In our view, the Guideline should therefore provide for exclusions.

To provide certainty for both service providers and customers, the Guideline could include a set of principles that must be met for a capital expenditure overspend to be excluded from the operation of the CESS. These principles could include:

1 AER, *Attachment 5: Capital expenditure | Final decision – Directlink transmission determination 2020–25,* p11
2 Directlink, *Directlink Revenue Proposal 2025-2030,* January 2024, p60
3 AER, *Attachment 9: CESS | Draft Decision - Directlink transmission determination 2020–25,* p5
4 National Electricity Rules, clause 6.5.8A

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- the capital expenditure project must represent a material (e.g. 5% of maximum allowed revenue, consistent with the threshold for contingent project applications) part of forecast capital expenditure in a revenue determination
- any capital expenditure overspend must have been demonstrably outside the service provider's control

Thank you for the opportunity to contribute to the review. If you have any questions about our submission, please contact Mark Allen at [redacted] or [redacted]

Regards,

[redacted]

Natalie Lindsay
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Economic Regulation and External Policy