AUSTRALIAN ENERGY REGULATOR

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Consumer Challenge Panel

CCP Sub-Panel No. 9

27/03/2018

AER Board
Mr Adam Petersen, Co-ord Director – TransGrid Determination – 2018-23
Australian Energy Regulator
By email: adam.petersen@aer.gov.au Cc: ccp@aer.gov.au

Dear Paula,

Re: TransGrid Determination – 2018-23

The proposal for Powering Sydney's Future is an important but controversial component of the TransGrid's Revenue Proposal. In order to assist AER in considering this proposal, CCP 9 convened a stakeholder forum on 19 March to test the level of agreement among stakeholders on the single cable proposal for PSF – i.e. whether it should proceed, and, if so, how it should be treated in the TransGrid revenue determination.

The attached note provides a summary of the discussion at the forum. In brief, there was broad support for an option under which:

1. AER approves the single cable project and inclusion of the proposed expenditure (subject to review by AER) in the revenue reset for 2018-23.
2. A supervisory committee is established to regularly review and advise the costs and timing of the project, although TransGrid would retain responsibility for decision-making for the project once it is approved by the AER.
3. If it is agreed that the project can be deferred or substantially reduced in scope the financial benefits would be passed through to consumers in full.

Elements (2) and (3) would be achieved through an agreement to be negotiated with TransGrid. The arrangements for the pass-through of the financial benefits from deferral would be specified in the agreement but CCP 9 considers it could work as follows:

1. if TransGrid defers all or part of the single cable proposal the return of and on the funds not spent will be returned to consumers through TransGrid's agreement to under-recover its allowed revenue by the equivalent amount
2. if TransGrid delivers project components in accordance with the proposed timing and scope but at a lower cost, it can retain the return of and on funds not spent due to these efficiency improvements.
3. the CESS will not apply to expenditures on the single cable proposal.

Component (1) requires that:

1. TransGrid publishes a detailed timetable for the component parts of the project and the assumed expenditure on those components.
2. TransGrid agrees that if, compared to the proposed timetable, component parts of the project are deferred:
    a. TransGrid will calculate the depreciation and return on expenditures allowed in the original determination but now deferred and provide this calculation to the AER and the Supervising Committee
    b. The AER will review the calculation and make the results of its review available to the Supervising Committee
    c. The Supervising Committee will review the calculations under (a) and (b) and agree with TransGrid the revenue allowed in the original determination on the components of the project deferred
    d. TransGrid will agree to not recover a component of its allowed revenues equivalent to the amount in (c).

CCP 9 supports this option. We recognise that the AER is in a difficult position. There are considerable uncertainties as to the timing and scope of the project. While we appreciate the move by TransGrid to an alternative position that includes greater consideration of DM and option values, these uncertainties remain and are difficult to resolve in the short term. We also recognise that the potential consequences of the increased risks should the project be delayed beyond when it is required are substantial. CCP 9 considers that the proposed option balances these risks in a manner that is in the long-term interest of consumers. It provides a basis for preliminary work on the project to commence without delay while providing the opportunity to refine the scope and timing of the project in light of subsequent information. Importantly, if the scope and timing is refined the benefits will be passed on to consumers in full.

In supporting the option set out in the attachment we would like to clarify two aspects of its operation. Firstly, the proposal applies only to the ‘single cable proposal’ and, as the summary makes clear, “it should not be assumed that the second cable will be required.” If TransGrid subsequently proposes to install a second cable it will be a separate, new investment and require a new RIT-T and review by AER before inclusion in the revenue base.

Secondly, under the option discussed at the Forum, TransGrid should not benefit from any deferral or substantial re-scoping of the project resulting in reduced expenditure in the current period. This also means that any reduction in costs in the current period due to deferral or re-scoping should not be included in the CESS calculation for the next period. However, it leaves open the question of how to treat reductions (or increases) in spending due to lower (higher) costs of delivering the component parts of the project in line with the original scope and timing CCP 9 considers that such efficiency gains or losses should not lead to a change in revenues in the current period, and should be subject to the CESS. This would mean that TransGrid would be subject to the normal risks and rewards from over- or underspends but not for the timing of the expenditure on the PSF.

We would be pleased to discuss this further if you wish.

Kind Regards,

B. Hughson

Eric Groom
Sub-panel Chairperson

Bev Hughson

Andrew Nance

Stakeholder Forum on Powering Sydney's Future

Summary

A Forum for Stakeholders was held on Monday 19 March with the objective of testing the level of agreement among stakeholders on the single cable proposal for PSF - whether it should proceed, and, if so, how it should be treated in the TransGrid revenue determination.

The Forum was briefed by:

- TransGrid on the 'single cable proposal' and the key underlying assumptions on demand projections, cable availability, value of customer reliability, and discount rate for evaluation of alternatives.
- AER on the progress with their assessment. While concerned about the demand projections the AER staff indicated that in their view the key parameters are the cable availability assumptions.
- John Howarth (consultant for ECA) on his further analysis of the proposal. Since he prepared the report published with ECA's submission John has received further information from TransGrid that has addressed some his concerns in regard to the cable availability, but he considers that there may still be some scope to defer the commissioning date.

There was broad agreement among stakeholders that:

1. investment will be required but some uncertainty around timing (in particular), scope, and cost remains
2. the 'single cable proposal' is a substantial improvement on the original proposal because it provides greater flexibility and opportunities for distributed resources (demand management and embedded generation).
3. the scope for distributed resources may be greater than expected, especially in the medium to long term, and it should not be assumed that the second cable will be required.
4. customers should not have to pay 'a dollar more or a dollar sooner' than needed
5. the key question is the balance between the risk and costs – the risks (and cost of those risks) if the commissioning is delayed beyond the optimal timing and the costs if capex is greater or earlier than needed.

ECA briefed the Forum on discussions with TransGrid which highlighted that concerns in regard to the timing and cost of the project remain and that there was agreement that a supervisory committee could be established to review the project cost and timing regularly. The objective is to ensure that spending is no more or no earlier than necessary. The Committee would be advisory, with TransGrid retaining responsibility for decision-making.

The issue that then arises is the impact on prices/revenues paid by consumers. If the project is approved in the revenue reset TransGrid retains the depreciation and return on funds not subsequently spent. This provides efficiency incentives, but in the context of PSF there is a question as to whether deferral would reflect the resolution of planning uncertainties rather than efficiency improvements, as they are commonly understood. If so, should the depreciation and return on funds not spent be immediately passed through? The AER's original proposal to treat the project as a contingent project reduced the risk of the consumers paying for a project that could be deferred but increased the risk of delaying the project beyond the point at which it may be required.

A range of options were set out:

1. approve the project and included it in allowed revenues without any special conditions
2. approve the project but establish a supervisory committee to review and advise on the cost and timing of the project, with an obligation on TransGrid to consider and take into account the recommendations of the committee.
3. split the project into pre-contracting (preparatory work) and post-contracting components. The former would be approved and the later made a contingent project
4. not approve the project but include it as a contingent project that can proceed if specified triggers are met (e.g. acceptance of a new RIT-T)

Some stakeholders were of the view that the single cable proposal should be approved, notwithstanding the uncertainties surrounding the project, because of the potential risks should the project be delayed and in recognition that there has been a lengthy process of consultation and review. Some other stakeholders, remained concerned about the uncertainties surrounding the project and considered that there may be scope to efficiently defer the project (i.e. the reduction in costs would be greater than the potential risks from deferral). For its part TransGrid made it clear that its primary concern was that deferral would increase the risk of supply interruptions and created reputational risks that it considered excessive. That is, its primary concerns were reputational rather than financial.

An option that reconciles the various views of stakeholders while being consistent with TransGrid's stated outcomes would be:

1. approval of the single cable project and inclusion of the proposed expenditure (subject to review by AER) in the revenue reset for 2018-23
2. development of an agreement with TransGrid that:
    a. a supervisory committee would be established to regularly monitor (initially every six months, then quarterly) the costs and timing of the project. The committee would be supported by independent technical experts.
    b. while responsibility for decision-making would continue to rest with TransGrid, the reports and recommendations of the supervisory committee would be public and carefully considered by TransGrid and implemented unless TransGrid demonstrates it would be inconsistent with other obligations.
    c. Where it is agreed that the project can be deferred or substantially reduced in scope the financial benefits would be passed through to consumers in full.

This option allows the project to proceed in accordance with the proposed timetable while achieving a price/revenue outcome comparable to the AER's proposal to include the project as a contingent project. It increases the flexibility in the timing of the project, reduces the time-lag in decision-making, and should help build customer support for the outcomes (assuming TransGrid has regard to the committee recommendations).

The approach reduces the financial incentives for TransGrid to defer expenditures and replaces this with transparent, regular review by a supervisory committee to ensure opportunities to defer or reduce the scope of the project are continuously monitored and pursued.

This is not intended to be a precedent for future large projects but provide a way forward to address the unique nature and timing of this project in relation to the regulatory decision.