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Submission to the AER

Expenditure incentives guideline for NSPs

Issues Paper

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Total Environment Centre's National Electricity Market Advocacy

Established in 1972 by pioneers of the Australian environmental movement, Total Environment Centre (TEC) is a veteran of more than 100 successful campaigns. For nearly 40 years, we have been working to protect this country's natural and urban environment, flagging the issues, driving debate, supporting community activism and pushing for better environmental policy and practice.

TEC has been involved in National Electricity Market (NEM) advocacy for ten years, arguing above all for greater utilisation of demand side participation — energy conservation and efficiency, demand management and decentralised generation — to meet Australia's electricity needs. By reforming the NEM we are working to contribute to climate change mitigation and improve other environmental outcomes of Australia's energy sector, while also constraining retail prices and improving the economic efficiency of the NEM — all in the long term interest of consumers, pursuant to the National Electricity Objective (NEO).

Expenditure incentives guideline

TEC appreciates the opportunity to make a submission to the AER regarding the expenditure incentive guidelines issue paper.

TEC does not have the requisite knowledge and technical expertise to engage with each of the issues and questions raised by the issues paper in detail. TEC, and other consumer groups, therefore rely on the AER to provide a balanced outcome which will be to the benefit of consumers.

We set out below our response to some of the key questions below.

Question 1

> *Do stakeholders agree with the issues that we have identified about declining incentives for efficient capex?*

We agree that the current incentive declines to the point of almost offering no incentive at all in the fifth year of the regulatory control period. We think that this is very likely to be the cause of the lack of discipline on capex in year five. Further, we agree that it makes sense to ensure that incentives are uniform across capex and opex.

While we understand that it is difficult to know whether capex increases toward the end of the control period as a result of the declining incentives to be efficient, we believe that there could at least be no harm in ensuring that the incentive is spread evenly across the period, and that this change would at least rule out the possibility that the regulatory framework is responsible for inefficient spending.

Question 2 (and Question 16)

> *Do stakeholders support our initial view that any capex sharing scheme should provide continuous incentives in each year of a regulatory control period?*

We agree that the benefit/penalty for under-/over-spending should be the same regardless of the year of the regulatory period. Specifically we agree that providing a continuous incentive would:

- ensure that the regulatory framework does not encourage overspending in the later years of the regulatory period, particularly where, as is often the case, a NSP's true WACC is lower than the regulated WACC;
- better align the incentives for capex and opex ; and
- provide NSPs with greater incentives to manage their capex programs on a continuous basis.

Question 3

> *Do stakeholders agree with our initial position that the penalty for overspending should be greater than 30 per cent?*

TEC agrees that the penalty should be greater than 30 per cent. In particular, we do not believe that this would lead to service decline. Indeed, such assertions have often been used to justify the overspending or inefficiency that the AER is seeking to deter. While we agree that aligning the incentive with opex incentives and service standards makes sense, we are aware that any proposal to increase penalties is likely to be met with resistance from networks. We therefore as the AER to continue to bear the interests of consumers in mind when considering whether to increase the penalty rate.

Question 5 & 6

> *Do stakeholders agree with our initial position that one capital expenditure sharing scheme should apply to all NSPs? If we were to tailor different schemes for individual NSPs, what criteria should we use to differentiate between NSPs?*

We do not agree that the AER should apply a uniform incentive to all NSPs. We believe that there are significant differences between government-owned and non-government owned NSPs, and between DNSPs and TNSPs, that justify making the extra effort to tailor incentives. Indeed, the AER acknowledges in the issues paper that these different NSPs respond in different ways to incentives, but simply dismisses the notion of differentiated schemes, without justifying why it believes the differences do not require tailored incentives.

While it is true that opex incentives are homogenous across the range of NSPs, the imperative is stronger with capex, as this is primarily what is driving price increases. Furthermore, opex is more stable and continuous across all NSPs, by comparison to capex which varies significantly. Therefore, the AER should strive to provide the most effective incentives possible. It may also be the case that there is an argument in favour of also differentiating opex incentives.

The most important criteria would be the type and ownership of the NSP, such that four base schemes are designed that can then be tailored based on more specific criteria.

Question 9

> *Do stakeholders agree with our initial position to apply a continuous asymmetric capex scheme with higher penalties for overspending than rewards for underspending?*

We agree that, given the expectation that NSPs will spend within their allowance in most circumstances, the scheme should be asymmetric in the manner described. In addition, while the general trend in regulation has been to provide strong incentives, but as little coercion as possible, this has not been effective in the NEM, leading to the large capex overspend we are now currently dealing with. In light of these circumstances, it is appropriate for the AER to provide an incentive, but to also be more forceful when NSPs are overspending.

Question 13

> *If we continue to use a revealed cost approach to forecast opex, should the same EBSSs remain largely in place, or are more significant changes required?*

TEC does not see any value in making significant changes to the EBSS, assuming that:

- the current model is working effectively;
- there continues to be no significant rise in opex in year four; and
- the AER continues to use the revealed costs approach.

Yours sincerely,

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