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30 October 2020

Mr Sebastian Roberts
General Manager, Transmission and Gas Branch
Australian Energy Regulator
Level 17, Casselden Place
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MELBOURNE VIC 3000

By email: Sebastian.Roberts@aer.gov.au

Dear Mr Roberts

Re: TransGrid 2023-28 Revenue Determination Process – Framework and Approach Initiation

Our current regulatory period ends on 30 June 2023. I am writing to request[1] the Australian Energy Regulator (AER) to amend or replace its Framework and Approach (F&A) paper for the next regulatory period, which will start on 1 July 2023 and end on 30 June 2028 (2023-28).

This letter sets out our preliminary views on the matters requiring the AER's consideration prior to the development of the F&A paper.

Service classification

We consider that the AER may be a need to review our current service classification, in light of the Australian Energy Market Commission's (AEMC) final report on system strength[2], which was published on 15 October 2020.

The AEMC's Final Report supports a more proactive approach to system strength, which would require transmission network service providers (TNSPs) to deliver an efficient level of system strength in accordance with guidance from the Australian Energy Market Operator (AEMO) on the network planning standards to apply to system strength zones and nodes.

On 27 April 2020, we submitted a Rule change request to the AEMC in line with the AEMC's Final Report[3], which if approved would confirm that system strength services are a prescribed transmission service. The AEMC's draft decision on our proposed Rule change is expected to be released in December 2020.

1 In accordance with clause 6A.10.1A(c)(1) of the National Electricity Rules (NER)
2 AEMC, Final Report, Investigation into system strength frameworks in the NEM, 15 October 2020. Found at Link
3 TransGrid, Rule change proposal on a new system strength framework for the NEM. Found at Link

Incentive schemes

We request a number of changes to the incentive schemes that are expected to apply in our 2023-28 Revenue Determination:

(i) Efficiency Benefit Sharing Scheme (EBSS)

The EBSS is intended to provide a continuous incentive for network service providers (NSPs) to pursue efficiency improvements across the regulatory period by fairly sharing the efficiency gains and losses between NSPs and network users.

With the recent falls in the discount rate[4], the target sharing ratio under the EBSS has fallen sharply compared with the 30 per cent applying under the capital expenditure sharing scheme (CESS).[5]

We request the AER to:

> review whether the EBSS is achieving the target sharing ratio, and if not,

> adjust for any changes in the target sharing ratio resulting from changes to the discount rate, such as by applying a multiplier to the gains/losses calculated under the EBSS, to ensure that incentives across the EBSS and the CESS are balanced and the target sharing ratio is achieved.

(ii) CESS

We support the continued application of the CESS to our business as usual (BAU) capex for the forthcoming regulatory period. However, as discussed below, we consider the application of the CESS to Major Projects should be addressed as part the broader considerations of how best to manage, and fairly allocate, risks associated with Major Integrated System Plan (ISP) Projects between NSPs and customers. We understand that this will be considered by the AER as part of its Transmission Investment Regulatory Review which will develop a series of Guidance Notes for the Major Projects[6].

(iii) Service Target Performance Incentive Scheme (STPIS)

We recently wrote to the AER outlining our concerns with the Market Impact Component (MIC) of the STPIS, which was last reviewed in in 2015. In its response, dated 18 August 2020, the AER advised that it considers there is no immediate need to review the STPIS, however it acknowledged that a review 'will be necessary in the near future'.

The AEMC has also flagged in its recent interim report on the coordination of generation and transmission investment (COGATI)[7] that the STPIS, and in particular the MIC, should be adjusted to reflect the cost of congestion rather than instances of material congestion.

We support the application of the STPIS to provide incentives to efficiently improve the reliability for customers, however we are seeking to clarify whether the AER intends to consult on the current version of the scheme.

(iv) Demand Management Innovation Allowance Mechanism (DMIAM)

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4 See AER Better Regulation, Explanatory Statement Efficiency Benefit Sharing Scheme for Electricity Network Service Providers. Found at Link. The EBSS assumes a real discount rate of 6 per cent.

5 As an illustration, on the basis of a three per cent real post-tax weighted average cost of capital the sharing ratio is now 84/16, i.e., customers receive 84 per cent of any efficiency gains with the TNSP retaining 16 per cent

6 AER letter, AER work program to support efficient delivery of actionable ISP projects —stakeholder views sought, 28 October 2020 (AER Letter re ISP projects, 28 October 2020)

7 Transmission Access Reform: Updated Technical Specifications And Cost-Benefit Analysis, 7 September 2020. Found at Link

The AER is currently developing the DMIAM in accordance with recent changes in the National Electricity Rule (NER)[8], which require it to develop a DMIAM for Transmission Network Service Providers (TNSPs). The AER's indicative timeline suggests that it will publish its Final DMIAM in June 2021.[9]

We support the application of the DMIAM in our 2018-23 Revenue Determination.

(v) Small-scale Incentive Scheme (SSIS)

Currently, there is no small-scale incentive scheme for TNSPs, although the AER has recently introduced a SSIS to apply to DNSPs[10].

We request the AER indicate in its F&A position paper whether it is considering developing a SSIS for application in our 2023-28 Revenue Determination.

Major Integrated System Plan (ISP) Projects

The commencement of the ISP Rules on 1 July 2020 to make AEMO's ISP and its optimal development path actionable will have significant implications for our 2023-28 Revenue Determination.

We expect to spend more than $6.5 billion (Nominal) over the next few years to deliver our share of the Major ISP Projects, including the Project Energy Connect, Queensland to New South Wales Interconnector, the Victoria to New South Wales Interconnector, HumeLink and KerangLink.

A key issue for the F&A is how best to address the risks associated with delivery of the Major ISP Projects that are anticipated to progress during the next regulatory period. This includes clarifying:

> how costs for Major ISP Projects will be assessed as part of the revenue determination process, and how they will allow for risk costs given the magnitude of these projects

> how the existing expenditure incentive schemes will apply, or may be modified, for these Major Projects, and

> how expenditure on Major ISP Projects will be treated for the purposes of the ex-post review provisions in the Rules.

Given the magnitude of these projects, we do not consider it appropriate or reasonable that we should bear the risks associated with unforeseeable and unquantifiable costs that may arise during the delivery of Major Projects, especially given that the delivery and timing are being driven by the broader ISP process. Further, it would not be appropriate for any increase in outturn costs for Major ISP Projects to trigger the ex post review provisions for all of our capex.

We understand that these issues will shortly be considered by the AER as part of its Transmission Investment Regulatory Review, which will involve the development of Guidance Notes on the following:

> project staging

> CPA assessment, and

> ex-post review.

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8 Clause 6A.7.6 (e) of the NER

9 AER Issues Paper – Demand management innovation allowance mechanism – Electricity transmission network service providers. Found at Link.

10 AER, Final Customer Service Incentive Scheme, July 2020. Fund at Link

In particular, the AER states that its Guidance Notes will consider 'the operation of the … CESS and ex-post measures, as well as the complementary role of cost pass through (and capital expenditure re-opener) provisions'.[11]

We understand that the AER will commence consultation on its Guidance Notes later this year with a view to publishing the final Guidance Notes by March 2021.

We also request the AER to provide in-principle approval for a nominated pass through event[12] to allow the costs associated with undertaking early works, required under the new ISP Rules. This is because:

> there is uncertainty outside of our control as to whether AEMO will require early works for ISP projects in its 2024 and 2026 ISPs, and if so, for which projects, and

> any requirement from AEMO for early works will impact our costs over the 2023-28 regulatory period.

We consider the treatment of these costs as a cost pass through is a more appropriate mechanism to address this uncertainty rather than incorporating an allowance for these uncertain costs as part of our forecast opex.

Regulatory Sandbox

The adoption of regulatory sandbox arrangements, as proposed by the AEMC, have the potential to provide additional value to customers at a time of rapid change in the energy supply system. The regulatory sandbox process is a framework within which participants can trial innovative concepts in the market under relaxed regulatory requirements on a time-limited basis and with appropriate safeguards in place.

We consider the F&A should recognise the potential application of regulatory sandbox arrangements in our 2023-28 Revenue Determination.

Stakeholder engagement

We intend to continue to put customers and other stakeholders at the centre of our Reset Project, including to inform key decisions in our 2023-28 Revenue Proposal.

We request the AER to detail in its F&A its expectations in relation to stakeholder engagement, including the role of the Customer Forum and developing an early engagement plan, having regard for recent DNSP and TNSP stakeholder engagement activities and approaches.

Next Steps

If you have any questions on this letter, please contact me [redacted]

Yours sincerely

Stephanie McDougall

Stephanie McDougall
Head of Regulation

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11 AER Letter re ISP projects, 28 October 2020, p.5

12 In accordance with clause 6A.7.3 (a1)(5) of the NER