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Electricity Infrastructure Roadmap Delivery Taskforce  
Department of Planning, Industry and Environment

Submitted electronically via [Electricity.Roadmap@dpie.nsw.gov.au](mailto:Electricity.Roadmap@dpie.nsw.gov.au)

## **Essential Energy – Network Infrastructure Projects Policy Paper – Submission**

Essential Energy welcomes the opportunity to provide a submission in response to the Department of Planning, Industry and Environment's (DPIE's) *Network Infrastructure Projects Policy Paper* (the Policy Paper).

Network infrastructure projects are critical to the success of the New South Wales (NSW) Electricity Infrastructure Roadmap (the Roadmap). It is however imperative that the required network investment be delivered efficiently (ie, at least cost to consumers), while also providing for full recovery of efficient costs for network operators.

Our submission therefore focuses on the need for:

- > Detailed consideration of the cost recovery arrangements for all types of network investment related to the Roadmap (as opposed to focusing on greenfield investment only), to ensure that network operators have a means of recovering all efficient costs;
- > Appropriate scrutiny of the costs incurred by the Infrastructure Planner in undertaking preparatory activities and development works, to provide adequate consumer protection;
- > Principles to be established in the Regulations that inform the development of the Network Authorisation Guidelines;
- > Clarity regarding the roles and responsibilities for a contestably selected Network Operator and the incumbent Network Service Provider (NSP) as well as adequate consideration of interface, cyber security and communication issues when assessing whether a REZ network infrastructure project is suitable for contestability;
- > Clarity regarding the arrangements for connecting load to REZ network infrastructure projects;
- > Development of clear principles governing any transition of network projects to being regulated under the national framework, and how the consequential impact on cost allocation across customers would be managed, to provide certainty to network operators, investors and consumers; and,
- > Clarity regarding the intent of the classifications of network infrastructure, to assist stakeholders in better understanding how these classifications flow through the network infrastructure project framework.

### **Network operators should have a means of recovering all efficient costs resulting from implementation of the Roadmap**

Essential Energy is pleased that the Policy Paper makes clear that distribution network costs arising from the Roadmap fall within the scope of the costs that can be recovered under the NSW framework, where the costs relate to investment authorised by the Consumer Trustee.

However, the focus of the examples and description provided in the policy paper is on greenfield, transmission investment. It is important to also work through the details of how the NSW framework would apply to other types of network investment associated with the Roadmap, in order to ensure that the regulations adequately provide for the intended cost recovery.

From a distribution perspective, we expect there will be four broad categories of REZ network infrastructure:

- > Contestable or non-contestable major greenfield investments that are wholly driven by the development of a REZ;
- > Major augmentations of existing regulated assets that are also providing shared services (ie, services regulated under the national framework);
- > Programs of minor capital works that are required as a consequence of the REZ (eg, managing connections and consequential minor works on the distribution network following the completion of LTESA auctions); and
- > Investments associated with building social licence for the Roadmap through the Regional Energy Strategy.

The discussion in the Policy Paper is focused on the first two categories of investment described above (major augmentations, either wholly or partially driven by REZ development). However, even for these investments, there are a number of detailed elements of the regulatory framework that have yet to be fully set out, but which are key to understanding the framework relating to cost recovery.

In the case of non-contestable investments, the Policy Paper notes that the Regulator's determination should be 'consistent with the existing regulatory determination for the network operator'.<sup>1</sup> Essential Energy would value further information in relation to what this 'consistency' is expected to mean in practice. In particular, for non-contestable investment:

- > Whether the Regulator will be required to include actual outturn efficient capex in the Regulatory Asset Base, regardless of whether it is above or below the capex forecast at the time of the regulatory determination;
- > Whether the framework will ensure the full recovery of depreciation over the life of the asset;
- > Whether the Regulator will be required to adopt the AER's most recent estimate of the regulatory weighted average cost of capital (WACC);
- > How operating costs will be treated where the asset supports both the Roadmap and the provision of regulated services to the national market; and
- > The incentive schemes that will apply, noting that it is important for these schemes to be tailored to the prevailing circumstances affecting the investment, ie, relating to investment in a single asset and the extent and nature of uncertainty in relation to future costs, the extent and nature of the cost pass throughs that will apply.

Further, the cost recovery arrangements for the other types of distribution network investment set out above do not appear to be canvassed in the Policy Paper.

Essential Energy notes that the more granular nature of distribution network investments means that many investments are more appropriately treated as a program of works, forecast over a period, rather than individual projects. In order to accommodate cost recovery for these minor distribution works, where they are required as a consequence of REZ development, it will be important to provide for the Consumer Trustee to authorise a program of works, and for the Regulator to make a determination on the associated revenue for this program.

Essential Energy would also welcome clarity on how cost recovery for investments associated with building social licence for the Roadmap through the Regional Energy Strategy will be accommodated under the NSW framework.

Providing certainty around the cost recovery arrangements for all network investment is critical to ensure that network operators have a means of recovering all efficient costs.

Essential Energy acknowledges that the EII Act provides for incumbent network operators to recover costs either through the Roadmap's regulatory arrangements or the national regulatory framework.

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<sup>1</sup> DPIE, *Network Infrastructure Projects (Part 5 of the Electricity Infrastructure Investment Act 2020) – Policy Paper*, p. 25.

However, the presence of multiple cost recovery channels creates a risk that some costs may ‘fall through the cracks’ and not be recoverable through either regulatory arrangement, either due to the timing of regulatory processes or the specifics of the cost recovery arrangements. This risk needs to be carefully worked through to ensure network operators have confidence that there is a means of recovering all efficient costs incurred.

In relation to the national framework, the expenditure triggered by a REZ development will be difficult to forecast materially in advance. It is therefore likely that cost recovery under the national framework would need to be dependent on the use of cost pass-through and contingent project mechanisms. However, these provisions are associated with materiality thresholds that may not be met. There is also a timing issue with even being able to appropriately specify cost pass-through events and contingent projects (with Essential Energy’s next regulatory proposal required to be lodged by 31 January 2023).

We look forward to working closely with DPIE to determine the appropriate approach to cost recovery for all types of network infrastructure that may be needed at the distribution level. Our preliminary analysis has highlighted that there a number of issues to be worked through under both the EII Act and the national framework approaches.

### Oversight is required over the Infrastructure Planner’s preparatory activities and development works

A key element of the proposed framework set out in the Policy Paper is that the Infrastructure Planner will be responsible for undertaking preparatory activities and development works ahead of the identification of the network operator and the Consumer Trustee’s authorisation of the network project. The Policy Paper explains that this responsibility will be wide-ranging – relating to route selection, land acquisition, network studies, community engagement and planning approvals. The proposed scope of these works undertaken by the Infrastructure Planner can be expected to involve significant costs (further increased where they extend to substantive land acquisitions).

Essential Energy is concerned that Ministerial approval of the Infrastructure Planner’s costs may not provide adequate consumer protection. By way of example, the equivalent ‘early works’ costs under the national framework would be subject to a staged contingent project application process, meaning that the prudence and efficiency of these preparatory costs would be tested by the Australian Energy Regulator (AER). We encourage DPIE to incorporate a similar prudence review that is appropriate in the context of the Roadmap. This may include the Regulator advising the Minister regarding the efficiency of the costs the Infrastructure Planner is seeking for these works.

While such a review is important for consumer protection, it would also contribute to investor confidence in the Roadmap. Specifically, it would mitigate the risk that the Regulator later determines a revenue allowance for a Network Operator that is insufficient to pay the Infrastructure Planner. Any disconnect between the costs owing to the Infrastructure Planner and the costs that the Regulator permits the Network Operator to recover could undermine the network infrastructure project procurement process.

### The Regulations should set out principles that will inform the development of the Network Authorisation Guidelines

We understand from the Policy Paper that the authorisation process is intended to serve the purpose of the Regulatory Investment Test (RIT) under the national framework (though it is not analogous). The RIT is a robust and transparent process that acts as an important safeguard for consumers by ensuring they only pay for efficient investments.

In our opinion, it is important that the authorisation process is also a robust safeguard for consumers. However, there is currently a lack of detail on how authorisation decisions will be made in practice, including the extent to which it will be based on a transparent cost benefit analysis and how it will take into account the full range of potential network projects. It appears that much of this detail will be developed through the Network Authorisation Guidelines, which will be developed and agreed by the Consumer Trustee and Infrastructure Planner.

It is important that the Regulations set out principles that will inform the development of the Network Authorisation Guidelines, to give stakeholders confidence that the process will operate as an effective safeguard for consumers. In our opinion, appropriate principles include:

- > Transparency; and

> Detailed consideration of the:

- available distribution network capacity;
- ability of non-network options, including Distributed Energy Resources (DER), to offset the need for network investment.

**Greater clarity is required regarding the roles and responsibilities of a contestably selected Network Operator and incumbent Network Service Provider**

Essential Energy acknowledges DPIE's intent to utilise a contestable process where possible to procure REZ network infrastructure projects – both transmission and distribution. However, there needs to be greater clarity on the allocation of the roles and responsibilities between a contestably-appointed Network Operator and the incumbent NSP.

The Policy Paper makes clear that Transgrid would remain the system operator for the transmission network. However, it is not clear whether the same applies for contestable distribution investments, ie, whether the incumbent DNSP will continue to be responsible for outcomes on the distribution network. Essential Energy expects that the incumbent DNSP would remain the operator of any new distribution assets. This raises a number of interface issues such as the liability for network performance and ongoing maintenance of the asset. These are important issues to work through when developing the contestable model.

In particular, it is unclear from the Policy Paper what the precise roles and responsibilities are of a contestable Network Operator and incumbent NSP with respect to the ongoing operation and maintenance of the asset. We note that the Policy Paper highlights that these arrangements will have reference to the designated network asset (DNA) framework under the NER. Under this framework we understand that the incumbent NSP would be required to provide O&M services to the contestable Network Operator, as a negotiated service. However, this is an area where much more clarity is required. Providing this clarity will be imperative to facilitating effective participation in a contestable process by both existing and potential Network Operators.

Clarification around these roles and responsibilities will also assist in understanding what elements of network infrastructure are suitable for contestability. In our opinion, there are likely to be elements of some network projects that are not suitable for contestability, and which need to continue to be owned and operated by the incumbent NSP. For instance, elements of a project relating to the cyber security and communications functions of the assets are not suitable to be contestably provided. This is because these functions are integral to the incumbent NSP meeting the IPART license condition obligations placed on it in relation to the overall safety and security of the network, and particularly its critical infrastructure obligations.

**Ability to connect new load to REZ network infrastructure requires clarification**

The principal purpose of REZ network infrastructure is to provide sufficient grid capacity to facilitate the level of intended dispatch capacity from a particular REZ. However, there may also be efficiencies if new load is permitted to connect to a REZ network infrastructure project, because it could offset the need for other network investment. Essential Energy would welcome clarity from DPIE as to whether new load will be able to connect to REZ network infrastructure, even where that infrastructure is owned by a party other than the incumbent NSP. In light of the Regional Energy Strategy seeking to encourage co-location of load and generation, such an approach would seem consistent with the intent of the Roadmap.

**Clear principles regarding transferring network investments to the national framework should be established**

Both the Policy Paper and the EII Act leave open the possibility that network infrastructure procured under the Roadmap can be transferred to be regulated under the national framework at a later date. We are supportive of the position that any transition to the national framework would not occur without the support of the network operator. Such an approach provides much needed certainty regarding the regulatory treatment of assets – promoting investor confidence.

In our opinion, investor confidence could be further enhanced – while also making any transfer to the national framework simpler – by setting out in the regulatory principles regarding how assets are to be transitioned to the national framework. These principles would likely to relate to determining the basis

on which the implied opening asset value would be set under the national regime at the time of any future transfer. This may include identifying:

- > The implied starting asset value and depreciation profile, at the time of authorisation, so that the residual value of the asset could be calculated at the time of transition; and
- > A process for conversion of the asset to regulation under the national framework.

Any principles should also incorporate a transparent means of assessing and managing the resulting impact on consumers, as recognised by DPIE in the Policy Paper. In particular, transitioning assets to the national framework may lead to significant cost increases for consumers in the geographic areas where the infrastructure is located. Under the Roadmap arrangements, network infrastructure costs will be socialised across all NSW electricity customers. This reflects the fact that all consumers benefit from the Roadmap, and so appropriately contribute to its cost. Under the national regime, costs may substantially increase for some consumers because for:

- > Transmission assets, costs are allocated partly on a locational basis; and
- > Distribution assets, costs are recovered from the customers served in the relevant geographic area.

#### Greater clarity is needed regarding the role of network infrastructure classifications in the broader framework

Essential Energy welcomes DPIE providing further guidance on how it intends to classify network infrastructure for the purposes of the Roadmap, drawing on stakeholder submissions to the Tranche Two Regulations Issues Paper. We are supportive of the proposed approach that seeks to define network infrastructure in a manner that is consistent with the national framework.

However, we consider that greater clarity is needed regarding the role of the classes of network infrastructure in the broader framework. DPIE previously proposed the classes of network infrastructure would delineate between:<sup>2</sup>

- > Existing and new network infrastructure that is not related to the Roadmap;
- > Network infrastructure that is related to a REZ under the Roadmap and subject to economic regulation under the EII Act; and
- > Private network assets that are related to a REZ under the Roadmap and not subject to economic regulation under the EII Act.

Our submission to the Tranche Two Issues Paper highlighted that these classes did not provide clarification on the types of network infrastructure that would be subject to economic regulation under the EII Act. While the new classes of network infrastructure explicitly call out types of network infrastructure, it is unclear how the classes relate to the broader framework (eg, regulation under the EII Act). Greater clarity on this point would assist stakeholders in better understanding how these classifications flow through the network infrastructure project framework.

If you have any questions in relation to our submission, please contact me directly via phone [REDACTED], or Mr Anders Sangkuhl, Regulatory Strategy Manager, at [REDACTED] or via phone [REDACTED].

Yours sincerely,



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<sup>2</sup> DPIE, *Tranche two regulations to support the electricity infrastructure roadmap | Issues paper*, April 2021, p 22.