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TransGrid:  
Electricity Price Guarantee  
Compliance  
2016-17

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**Report prepared for the NSW Government by  
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NSW Electricity Price Commissioner**

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## Abbreviated terms

<b>Abbreviation</b>	
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
EBSS	Efficiency Benefit Sharing Scheme
MAR	Maximum allowed revenue
NEL	National Electricity Law
NEO	National Electricity Objective
PTRM	Post Tax Revenue Model

# Executive Summary

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I have prepared this report in my role as the NSW Electricity Price Commissioner in accordance with the legislative requirements of the *Electricity Network Assets (Authorised Transactions) Act 2015*, New South Wales (the Act).

Section 8(2)(b) of the Act specifies that the Treasurer is to request the Price Commissioner to provide:

*“an annual report, for each completed authorised transaction, on compliance by the authorised network operator with its obligations under its electricity price guarantee”.*

The Treasurer requested this report in relation to the compliance of TransGrid with its obligations for the 2016-17 financial year.

This report may be released publically at the discretion of the Treasurer.

TransGrid has provided written evidence of its intent to comply with its obligations under the electricity price guarantee, which I reviewed. I also sought information from the Australian Energy Regulator (AER).

My findings with respect to each component of the electricity price guarantee are summarised below.

## **Part (a) – Total network charges:**

This component on the guarantee places an obligation on TransGrid to ensure that its total network charges for 2018-19 are lower than its total network charges for 2013-14.

TransGrid’s compliance with this component of the guarantee cannot be assessed at this stage. I will revisit this assessment in a future report.

**Part (b) – Investment in, operation and use of electricity services:**

This component of the guarantee requires TransGrid to promote efficient investment in, and efficient operation and use of electricity services for the long term interests of consumers of electricity with respect to price, quality, safety, reliability and security of supply of electricity. This requirement mirrors part of the National Electricity Objective.

The AER is responsible for the economic regulation of TransGrid in accordance with the National Electricity Law and National Electricity Rules. In doing so, it must be satisfied that its revenue determinations for TransGrid will or are likely to contribute to the achievement of the National Electricity Objective to the greatest degree.

The AER has advised that it has not raised any compliance issues with TransGrid in relation to the efficient investment in, and/or efficient operation and use of electricity services in 2016-17 for the long term interests of consumers of electricity.

I am satisfied that TransGrid has complied with its obligations under this component of the guarantee in 2016-17.

**Part (c) – Efficiency Benefit Sharing Scheme:**

This component of the guarantee requires TransGrid to comply with any applicable Efficiency Benefit Sharing Scheme (EBSS) developed by the AER. The AER decides how to apply the EBSS through its revenue determinations, and also oversees network business compliance through the same process.

TransGrid has submitted a revenue reconciliation to the AER as part of its 2016-17 annual regulatory accounts.

I am satisfied that the current regulatory framework in place is sufficient to ensure TransGrid's compliance with this component of the guarantee for 2016-17.

# 1. Background

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## 1.1 Introduction

The NSW Government completed the 99-year lease of TransGrid in December 2015.

Under section 8(1) of the *Electricity Network Assets (Authorised Transactions) Act 2015* (the Act), the successful consortium provided an electricity price guarantee to the effect that:

- a) the authorised network operator's total network charges for the financial year ending 30 June 2019 will be lower than the network operator's total network charges for the financial year ending 30 June 2014, and
- b) the authorised network operator will promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, safety, reliability and security of supply of electricity, and
- c) the authorised network operator will comply with any Efficiency Benefit Sharing Scheme developed by the AER for the sharing of efficiency gains and losses between network operators and their customers that is applicable to the network operator.

The NSW Electricity Price Commissioner is required to report to the Treasurer on TransGrid's compliance with its obligations under its electricity price guarantee. Specifically, section 8(2)(b) of the Act specifies that the Treasurer is to request the Price Commissioner to provide:

*“an annual report, for each completed authorised transaction, on compliance by the authorised network operator with its obligations under its electricity price guarantee”.*

The Act sets out requirements for provision of information to the Electricity Price Commissioner, including that:

- Section 8(3) – *“a public sector agency must comply with any reasonable request by the Price Commissioner that the agency provide information to the Price Commissioner for the purposes of reports under this section (with any dispute as to the reasonableness of a request to be decided by the Secretary of the Department of Premier and Cabinet).”*
- Section 8(5) – *“an authorised network operator must within 2 months after the end of each financial year provide to the Price Commissioner such information as the Price Commissioner may reasonably require to enable the Price Commissioner to report on compliance by the authorised network operator with its obligations under its electricity price guarantee.”*

The Act also provides for the independence of the Electricity Price Commissioner, with section 8(4) noting that:

*“the Price Commissioner is not subject to control or direction by or on behalf of the Government in connection with any report of the Price Commissioner.”*

## **1.2 The assessment process**

TransGrid submitted information to me under section 8(5) of the Act to demonstrate its compliance with its obligations under the electricity price guarantee.

I reviewed this submission and also sought information from the Australian Energy Regulator (AER).

This report outlines the relevant evidence and assesses TransGrid’s compliance with its electricity price guarantee in 2016-17.

## 2. Assessment of compliance

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### 2.1 Part (a) – Total network charges

#### Guarantee

TransGrid has guaranteed that its total network charges for the financial year ending 30 June 2019 will be lower than its total network charges for the financial year ending 30 June 2014.

As defined under section 8(6) of the Act:

- **network charges** means revenue collected by a network operator in respect of regulated services provided by the network operator.
- **total network charges** for a period means the total revenue collected by a network operator at any time (whether or not during the period concerned) in respect of regulated services provided by the network operator during that period.
- **regulated services** means the following direct control network services (within the meaning of the National Electricity (NSW) Law):
  - (a) a standard control service or prescribed transmission service,
  - (b) any other service prescribed by the regulations.

#### Assessment

TransGrid's compliance with this component of the guarantee cannot be assessed at this stage. I will revisit this assessment in a future report.



## 2.2 Part (b) – Investment in, operation and use of electricity services

### Guarantee

TransGrid has guaranteed that it will promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, safety, reliability and security of supply of electricity.

This component of the guarantee mirrors an excerpt of the National Electricity Objective (NEO) defined in section 7 of the National Electricity Law (NEL):

*“The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to—*

*(a) price, quality, safety, reliability and security of supply of electricity; and*

*(b) the reliability, safety and security of the national electricity system.*

The NEL requires the Australian Energy Regulator (AER), Australian Energy Market Commission (AEMC) and the Australian Energy Market Operator (AEMO) to have regard to, or contribute towards the achievement of, this objective when carrying out their functions or powers under the Law. It also requires the Australian Competition Tribunal to have regard to the objective in its decisions. The main requirements in this regard are summarised in Table 1.

**Table 1: Selected references to National Electricity Objective in the NEL**

NEL reference	Requirement
s 16(1)(a)	The AER must, in performing or exercising an AER economic regulatory function or power, perform or exercise that function or power in a manner that will or is likely to contribute to the achievement of the national electricity objective.
s 16(1)(d)(i)	The AER must, in performing or exercising an AER economic regulatory function or power, if the AER is making a reviewable regulatory decision and there are 2 or more possible reviewable regulatory decisions that will or are likely to contribute to the achievement of the national electricity objective – make the decision that the AER is satisfied will or is likely to contribute to the achievement of the national electricity objective to the greatest degree (the <i>preferable reviewable regulatory decision</i> ).
s 32	In performing or exercising any function or power under this Law, the Regulations or the Rules, the AEMC must have regard to the national electricity objective.
s 88 (1)	The AEMC may only make a Rule if it is satisfied that the Rule will or is likely to contribute to the achievement of the national electricity objective.
s 49(3)	AEMO must, in carrying out functions referred to in this section (statutory functions), have regard to the national electricity objective.
s 71P(2a)(c)	Despite subsection (2), the (Australian Competition) Tribunal may only make a determination – if – the Tribunal is satisfied that to do so will, or is likely to, result in a decision that is materially preferable to the reviewable regulatory decision in making a contribution to the achievement of the national electricity objective (a materially preferable NEO decision) (and if the Tribunal is not so satisfied the Tribunal must affirm the decision).

Source: National Electricity Law

Under the National Electricity Rules, the AER's revenue determination takes into account the both efficient costs of, and the costs that a prudent operator would require to:

- comply with all applicable regulatory obligations or requirements associated with the provision of prescribed transmission services (including those that relate to quality, reliability or security of supply); and
- maintain the safety of the transmission system through the supply of prescribed transmission services.<sup>1</sup>

### **Evidence of compliance**

TransGrid has advised that its prices are set in accordance with the National Electricity Law, Rules, Pricing Principles and approved Pricing Methodology and the AER's revenue decision.

The AER's current revenue decision for TransGrid covers the period from 2014-15 to 2017-18. The determination allowed 18.5% less revenue than in TransGrid's revised proposal, with the difference primarily driven by the AER's decision on the rate of return.<sup>2</sup> The AER considered that TransGrid had sought a rate of return that was higher than necessary given the current investment environment.

The National Electricity Rules require TransGrid to submit a certified annual statement to the AER which provides a true and fair statement of its financial and operating performance.<sup>3</sup> The statement must be consistent with information guidelines published by the AER.

The National Electricity Rules specify the purposes that AER may use these statements for. These purposes include monitoring, reporting on and enforcing

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<sup>1</sup> National Electricity Rules, Chapter 6A, Part C, clauses 6A.6.6 and 6A.6.7

<sup>2</sup> <https://www.aer.gov.au/system/files/AER%20-%20Final%20Decision%20%28Substituted%29%20TransGrid%20transmission%20determination%20-%20Attachment%201%20-%20maximum%20allowed%20revenue%20-%20July%202015.pdf>

<sup>3</sup> National Electricity Rules, Chapter 6A, Part F, clause 6A.17.1

compliance with the total revenue cap for a regulatory control period, the maximum allowed revenue for each regulatory year, and any requirements imposed under the transmission determination.

Under the National Electricity Law, the AER is also able to issue Regulatory Information Notices to TransGrid to support its regulatory responsibilities.<sup>4</sup>

TransGrid has submitted its Board-approved, audited Regulatory Accounts for 2016-17 and its 2016-17 Annual Regulatory Information Notice to the AER.

TransGrid is also required to comply with the service standards specified in the National Electricity Rules. On 13 March 2017, the AER wrote to TransGrid with the outcome of its review of TransGrid's performance against its transmission service target performance incentive scheme for the 2016 calendar year.

The AER has advised that it has not raised any compliance issues with TransGrid in relation to the efficient investment in, and/or efficient operation and use of electricity services in 2016-17 for the long term interests of consumers of electricity.

## **Assessment**

This component of the guarantee requires TransGrid to promote efficient investment in, and efficient operation and use of electricity services for the long term interests of consumers of electricity with respect to price, quality, safety, reliability and security of supply of electricity. This requirement mirrors part of the National Electricity Objective.

The AER is responsible for the economic regulation of TransGrid in accordance with the National Electricity Law and National Electricity Rules. In doing so, it must be satisfied that its revenue determinations for TransGrid will or are likely to contribute to the achievement of the National Electricity Objective to the greatest degree.

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<sup>4</sup> National Electricity Law, Part 3, Division 4

The AER has advised that it has not raised any compliance issues with TransGrid in relation to the efficient investment in, and/or efficient operation and use of electricity services in 2016-17 for the long term interests of consumers of electricity.

I am satisfied that TransGrid has complied with its obligations under this component of the guarantee in 2016-17.

## 2.3 Part (c) – Efficiency Benefit Sharing Scheme

### **Guarantee**

TransGrid has guaranteed that it will comply with any applicable Efficiency Benefit Sharing Scheme (EBSS) developed by the AER for the sharing of efficiency gains and losses between network operators and their customers.

In applying the EBSS, the AER aims to provide a continuous incentive for a network business to pursue efficiency improvements in operating expenditure and to share efficiency gains with customers.

### **Evidence of compliance**

Under the National Electricity Rules (specifically Chapter 6A), TransGrid is required to comply with any applicable EBSS developed by the AER for the sharing of efficiency gains and losses between network operators and their customers.

The sharing of efficiency gains and losses is determined by the AER as part of its revenue determination for TransGrid, in accordance with clauses 6A.6.5, 6A.4.2(a)(6) and 6A.5.4(a)(5) of the National Electricity Rules (see Appendix A for extracts of these Rules).

The AER's revenue determination for TransGrid over the 2014-15 to 2017-18 regulatory control period set the EBSS carryover amounts based on TransGrid's operation during the 2009-10 to 2013-14 regulatory control period. These amounts are modelled by the AER in the published Post Tax Revenue Model (PTRM) and included in the build-up of the unsmoothed annual revenue path for the regulatory control period in its final decision (see Table 2). The revenue determination also confirmed that the EBSS would apply to TransGrid between 2014-15 and 2017-18.

**Table 2: TransGrid revenue adjustments in the Post Tax Revenue Model for EBSS (\$m, 2013-14)**

	<b>2014-15</b>	<b>2015-16</b>	<b>2016-17</b>	<b>2017-18</b>	<b>Total</b>
Efficiency Benefit Sharing Scheme (carryover amounts)	21.07	13.22	14.99	11.58	60.86

Source: AER, PTRM (Substitute) TransGrid transmission determination 2014-18

The EBSS carryover amounts in Table 2 above form part of TransGrid’s annual building block revenue requirement that is calculated by the AER. The AER then smooths the annual requirements over the regulatory control period to produce the maximum allowed revenue (MAR) for each year. Accordingly, EBSS allowances are incorporated in the MAR which TransGrid targets when calculating its prices, rather than recovered from customers as a separate charge.

TransGrid has reported that its prices for 2016-17 were set in accordance with the revenue allowance set by the AER, which includes the EBSS carryover amounts.

The AER has advised that it oversees TransGrid’s compliance with the EBSS as part of its revenue determinations every five years, with allowances or penalties provided for each forthcoming year of the new regulatory control period based on performance in the preceding period.

TransGrid has submitted its 2016-17 annual regulatory accounts to the AER, which includes a revenue reconciliation.

### **Assessment**

This component of the guarantee requires TransGrid to comply with any applicable EBSS developed by the AER. The AER decides how to apply the EBSS through its revenue determinations, and also oversees network business compliance through the same process.

I am satisfied that the current regulatory framework in place is sufficient to ensure TransGrid's compliance with this component of the guarantee for 2016-17.



# Appendix A: National Electricity Rule excerpts – Chapter 6A

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## National Electricity Rules – Version 92 – Chapter 6A:

### Efficiency Benefit Sharing Scheme

#### 6A.6.5 – Efficiency benefit sharing scheme

- (a) The AER must, in accordance with the transmission consultation procedures, develop and publish an incentive scheme or schemes (efficiency benefit sharing scheme) that provide for a fair sharing between Transmission Network Service Providers and Transmission Network Users of:
- (1) the efficiency gains derived from the operating expenditure of Transmission Network Service Providers for a regulatory control period being less than; and
  - (2) the efficiency losses derived from the operating expenditure of Transmission Network Service Providers for a regulatory control period being more than,
- the forecast operating expenditure accepted or substituted by the AER for that regulatory control period in accordance with clause 6A.6.6(c), clause 6A.6.6(c1) or clause 6A.13.2(b)(3) and (5) (as the case may be).
- (b) In developing and implementing an efficiency benefit sharing scheme, the AER must have regard to:
- (1) the need to provide Transmission Network Service Providers with a continuous incentive (that is equal in each year of any regulatory control period) to reduce operating expenditure;
  - (2) the desirability of both rewarding Transmission Network Service Providers for efficiency gains and penalising Transmission Network Service Providers for efficiency losses;

- (3) any incentives that Transmission Network Service Providers may have to inappropriately capitalise operating expenditure; and
  - (4) the possible effects of the scheme on incentives for the implementation of non-network options.
- (c) At the same time as it publishes an efficiency benefit sharing scheme under this clause 6A.6.5, the AER must also publish parameters (the efficiency benefit sharing scheme parameters) for the scheme. For the avoidance of doubt, unless the AER provides otherwise in that scheme, such values may differ as between Transmission Network Service Providers and over time.
  - (d) The AER must set out in each efficiency benefit sharing scheme any requirements with which the values attributed to the efficiency benefit sharing scheme parameters must comply, but such requirements must not be inconsistent with those factors to which the AER must have regard under paragraph (b).
  - (e) The AER must develop and publish the first efficiency benefit sharing scheme by 28 September 2007, and there must be an efficiency benefit sharing scheme in force at all times after that date.
  - (f) The AER may, from time to time and in accordance with the transmission consultation procedures, amend or replace an efficiency benefit sharing scheme, except that no such amendment or replacement may change the application of the scheme to a Transmission Network Service Provider in respect of a regulatory control period that has commenced before, or that will commence within 15 months of, the amendment or replacement coming into operation.

#### **6A.4.2 – Contents of revenue determination**

- (a) A revenue determination for a Transmission Network Service Provider is to specify, for a regulatory control period, the following matters:

...

- (6) the values that are to be attributed to the efficiency benefit sharing scheme parameters for the purposes of the application to the Transmission Network Service Provider of any efficiency benefit sharing scheme that applies in respect of the regulatory control period.

#### **6A.5.4 – Building blocks approach**

- (a) **Building blocks generally**

The annual building block revenue requirement for a Transmission Network Service Provider for each regulatory year of a regulatory control period must be determined using a building blocks approach, under which the building blocks are:

...

- (5) the revenue increments or decrements (if any) for that year arising from the application of any efficiency benefit sharing scheme, capital expenditure sharing scheme, service target performance incentive scheme or small-scale incentive scheme.