20 March 2025

Mr Arek Gulbenkoglu
General Manager, Network Expenditure
Australian Energy Regulator

Dear Mr Gulbenkoglu,

Capital Expenditure Incentive Guideline Review

The Justice and Equity Centre (JEC) welcomes the opportunity to respond to the Australian Energy Regulator's (AER) review of the Capital Expenditure Incentive Guideline (the Review).

The JEC supports a robust ex-post review process for network service providers (NSP) and empowering the AER to ensure that inefficient capital expenditures are not passed on to consumers.

Accordingly, we support allowing ex post reviews occurring at various stages of projects (excepting Early Works), per the AEMC's ruling. However, thresholds for project or stage completion should relate to pre-identified qualitatively defined components of work instead of percentages of allowable spend, which are arbitrary and able to be manipulated.

We do not support the proposal to allow the AER to adjust the Capital Expenditure Sharing Scheme (CESS) penalties for transmission network service providers (TNSP) where overspending is deemed to be efficient. While this may appear to improve the 'accuracy' of the AER's assessment, it could in fact undermine the core assumptions underpinning the scheme as it is currently designed and leave consumers worse off.

Introducing staged ex post reviews to TSNP projects

A positive ambition of the regulatory framework should be to increase the capacity of the AER to fulfil its core purpose of promoting the interests of consumers through ensuring efficient network investments.

The AER, in this area of its operations, is required to regulate a small number of very large entities and to do so predominantly via a small number of very material (and complex) decisions. The AER's decisions in this area relate to projects that are often politically charged, deemed to be central to the success or failure of various Australian governments' energy agendas. In this context, the capacity of the AER to do its core job of defending the interests of consumers can, in practice, be circumscribed.

One way to alleviate this issue and better enable the AER to undertake its role for consumers is to make the assessments required of the AER more manageable and practical.

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At the start of large network projects, stages could be defined based on discrete spending operations. For example, these could include things like ‘route planning and land acquisition’, ‘prepurchase of contracts for materials and services’, and so on. Once spending on these discrete categories had been completed within the project, the AER could conduct limited ex post reviews, assessing the efficiency and prudency of the capex on these items in isolation.

This would have the effect of increasing certainty for NSPs by reducing the materiality of risk associated with each ex post regulatory decision. It could help increase the capacity of the AER to protect consumers’ interests in difficult circumstances by reducing the materiality and complexity of each individual decision.

Adjusting the CESS penalties

We do not support the proposal to adjust the CESS according to an assessment of efficiency on the basis that it is likely to have unintended consequences which are not in the consumer interest.

Currently, the overspend on a project is assessed in the ex post review, and divided into two parts:

- Overspend that deemed inefficient or imprudent
  This is borne by the NSP by not allowing it to be added to the capital base, and

- The ‘efficient’ overspend
  This is shared between the NSP, who pay 30% of the overrun, and consumers, who pay 70% of it, via the CESS.

The framework, as it is currently designed, does not rely on the regulator determining which outcomes are due to the intentions of the NSP and which are due to ‘luck’ or other circumstances not in the NSP’s control. While this may appear counter-intuitive on the surface, it recognises that such an assessment is effectively impossible. For example, there may be a situation where an NSP brings forward its procurement of a necessary supply and immediately after securing the purchase, the price of that input increases. Determining whether this saving was due to an informed assessment, or simply a fortunate coincidence is beyond the capacity of the regulator, and very likely beyond the capacity of the NSP itself in most cases.

The regulatory framework takes this limitation as given and aims to maximise consumer interest in that context. Accordingly, the CESS is intended to function by incentivising NSPs to pursue cost-saving measures, free from the risk that these will be attributed to mere luck and the benefits allocated entirely to consumers. This does mean that consumers assume some risk that the NSP will be compensated for savings which would have occurred regardless.

While we may query whether this is the most effective approach to promoting efficiency, this process is not fundamentally assessing the CESS but, assuming it exists, to consider how best to apply it to promote the consumer interest.

In this context we do not agree with the regulator moving to assess each element of overspending on a spectrum of efficiency, as we believe it may undermine the design of the scheme. Given the impracticality of assessing the efficiency of individual aspects of expenditure, it is likely that in reviewing overspends, the AER will 'discover' very little overspending that can unambiguously be said to be in the control of the NSP and inefficient. Practically, we can then expect the 30% share of the overspends that is currently borne by NSPs to instead become a ceiling, and the amount borne by NSPs to consistently fall below this. This would essentially amount to an erosion of the CESS as it is intended to operate. This is not an outcome that is in consumers' interests

We welcome the opportunity to meet with the AER to discuss these issues in more depth. Please contact Michael Lynch at mlynch@jec.org.au regarding any further follow up.

Yours sincerely,

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Senior policy officer

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