

2 October 2018

The Hon Angus Taylor MP
Minister for Energy
Federal Member for Hume
Parliament House
Canberra, ACT 2600

By email: angus.taylor.mp@aph.gov.au

Dear Minister,

Re: Ensuring investment in critical network infrastructure and protecting consumer interests

I am writing to introduce myself and Spark Infrastructure. We share the same objectives; to develop sustainable evidence-based energy policies that will deliver reliable, affordable, and low emission energy to consumers.

We would like to work with you to cut through the politics that has plagued energy debate and policy in recent times and establish a shared view of the facts regarding energy network businesses and the regulatory framework under which they operate.

Energy networks are critical to a low cost, low emission, reliable and secure energy supply system:

- They improve the utilisation of existing generation and ensure only an optimised amount of new renewable distributed energy resources (**DER**) is required to be built to meet consumer demand;
- Enhanced connectivity and electricity flow between regions ensures the wholesale market operates efficiently reducing wholesale prices and price volatility; and
- They provide a platform to support new behind the meter technologies and dynamic two-way energy flows that empower consumers to manage their energy use and bills.

Opportunities to reduce costs to consumers exist across the energy supply chain. However, we consider that the opportunities to reduce costs in privatised electricity networks have been exhausted. Continued intervention and regulatory change will have the opposite effect to that intended, increasing risk that drives up costs and reduces incentives to invest. This will increase prices to consumers and put at risk reliable and secure services.

Spark Infrastructure

Spark Infrastructure has been listed on the Australian Stock Exchange (**ASX**) since 2005 and has a current market capitalisation of around \$4 billion. Our investment businesses transport electricity to 5.5 million customers in South Australia, Victoria and NSW, and importantly provide high voltage interconnection between regions in the National Electricity Market (**NEM**). Spark Infrastructure's investment portfolio comprises 49% interests in SA Power Networks (**SAPN**) (South Australia), and CitiPower and Powercor (together known as Victoria Power Networks (**VPN**), in Victoria), and a 15% interest in TransGrid (NSW), the transmission company in NSW. Spark Infrastructure is approximately 75% owned by Australian professional, superannuation and retail investors, with the remaining 25% being held by foreign investors.

Spark Infrastructure and its underlying investors are the providers of long-term equity capital to our network businesses to build and maintain electricity transmission and distribution assets that support an affordable, reliable and safe electricity system. We are very focused on ensuring that our network businesses provide the services our customers need, at least cost.

In a stable environment network prices have declined and will continue to do so

Network prices have declined by between 3% and 5% across the NEM since 2014 and are expected to continue to decline for privately owned networks. The contribution of network charges to the average bill for residential customers has also declined since 2014. In contrast, wholesale electricity costs have increased by 130% and the contribution of wholesale electricity costs to the average bill for residential customers has increased by between 36% and 80%.¹ Increasing electricity bills are not being driven by network charges.

The price reductions delivered by network businesses have occurred in response to strong incentives under the regulatory regime to achieve efficiencies whilst maintaining services. These incentives are effective where network businesses respond to financial incentives. This is more evident for privately owned networks.

The businesses in our investment portfolio have a strong track record in performance.

For SAPN and VPN, distribution network prices have remained flat in real terms since privatisation (late 1990's) and for our newest investment, TransGrid prices are lower in 2017 in real terms than in 1995. TransGrid's prices will again fall in real terms over their new five-year regulatory period which commenced on 1 July 2018. At the same time, our businesses are leaders in efficiency, reliability and safety² and have absorbed costs of new obligations such as the advanced interval meter roll-out (smart meters) in Victoria and new licensing obligations and constraints on transforming the workforce imposed by the Government through the TransGrid acquisition process.

Private network businesses have not over-invested

These facts may differ to those that have become popular with politicians and the media. For example, the Australian Competition and Consumer Commission (**ACCC**)³ and the Grattan Report⁴ have referred to over-investment and under-utilisation. However, these findings are not true for all networks and were found not to be true at all for private networks in South Australia and Victoria (in contrast to the historical State-owned distribution network businesses in NSW and Queensland). Clearly the root issue is in government ownership, and not the regulatory framework.

The network expenditure patterns were recently highlighted by the Australian Energy Markets Commission (**AEMC**) which showed a sharp decline in capital expenditure since 2012-13, with the lowest level in ten years recorded last year and regulated asset base (**RAB**) growth plateauing since 2014-15.⁵ The sharp decline in investment has been driven by a significant reduction in returns implemented in the Australian Energy Regulator's (**AER's**) previous 2013 Rate of Return Guideline (**RORG**), strengthening of incentives for capital efficiencies and further privatisation.

¹ The Grattan Institute, Mostly Working, Australia's Wholesale Electricity Market, July 2018, p. 3 and 8.

² Spark Infrastructure HY2018 Investor Presentation available at <https://sparkinfrastructure.com/investor-centre/reports-and-presentations>

³ ACCC, Retail Electricity Pricing Inquiry, Final Report, June 2018.

⁴ The Grattan Institute, Down to the wire: A sustainable electricity network for Australia, 25 March 2018.

⁵ AEMC, Economic Regulatory Framework Review, Promoting efficient investment in the grid of the future, July 2018, Section 3.

Sovereign and regulatory risks are increasing and will put future investment at risk

Frequent intervention by government and decisions by the AER that put primacy on the short-term price impacts rather than incentives for efficiency and the long-term price and service impacts required to be taken in to account by Law,⁶ are unnecessarily increasing sovereign and regulatory risk. Examples of these types of interventions include:

- The unilateral abolition of Limited Merits Review (LMR) prior to the completion of the COAG Energy Council commissioned process which had agreed to reform rather than remove the LMR framework;⁷
- Through the legislation to make the RORG binding, which included:
 - Considerable narrowing of rights to Judicial Review on rate of return issues at the same time as significantly increasing the discretion of the AER (noting that the COAG Energy Council had only agreed to remove LMR on the basis that access to Judicial Review remained); and
 - Overriding the important governance arrangements for the powers, roles and decisions of Australian energy institutions under the Australian Energy Market Agreement;⁸
- ACCC's proposal to consider rule changes to introduce asset stranding risk on past efficient investment;⁹
- The politically driven review of the regulatory tax approach¹⁰ which is also shining a light on the quality of Australian Taxation Office data and related issues that are best dealt with through Commonwealth taxation policy rather than the regulatory system. The COAG Energy Council subsequently released proposed changes to the national energy rules on the regulatory approach to tax prior to the review being concluded or even a proposed position being reached; and
- The unpredictable and de-stabilising draft RORG (issued July 2018)¹¹ which proposes a significant cut in equity returns with no analysis at all of the impacts on investment incentives or the longer-term price and service (eg. security and reliability) outcomes for consumers.

We are very concerned with the integrity and robustness of the draft RORG process as the draft outcomes do not reconcile to market evidence or the agreed positions of experts involved in the process. In addition, the AER has not considered the aggregate impact of the draft outcomes on the financial position of the Network Service Provider (NSP) or the long-term service and reliability impacts on consumers, as it is required to do.

These risks reduce incentives for investment and will increase the cost of debt and equity at a time when more, not less, investment is needed in the energy system. Paradoxically a reduction in regulated equity returns will adversely affect credit ratings and hence drive up debt costs. As the level of gearing in these businesses is relatively high versus the equity component, it is likely that the net cost to consumers will in fact increase, and with effect immediately.

It is forecast that 45 terawatt hours (TWh) of coal-fired generation will be retired within the next 12 years and, according to Australian Energy Market Operator (AEMO), will need to be replaced by up to 90 TWh of gas and renewable energy sources. Hence, the role of the grid is expected to expand considerably to facilitate multi-directional energy flows between consumers and a diverse mix of generators and storage points, spread geographically across the NEM. New transmission is needed to optimise the amount of new generation build required and to relieve constraints that drive up wholesale prices.

⁶ See the National Gas Objective (NGO), National Electricity Objective (NEO) and Revenue and Pricing Principles (RPPs) in the National Gas Law and National Electricity Law

⁷ Spark Infrastructure, Letter to the committee Secretary, Senate Standing Committees on Environment and communications, Senate inquiry into the abolition of limited merits review (LMR), 19 September 2017 available at <https://sparkinfrastructure.com/about/economic-regulation>

⁸ Spark Infrastructure, Letter to the Hon Josh Frydenberg MP, 15 June 2018. Available at <https://sparkinfrastructure.com/about/economic-regulation>

⁹ ACCC, Retail Electricity Pricing Inquiry, Final Report, June 2018, p. xix.

¹⁰ AER, Initial Report, Review of regulatory tax approach, June 2018.

¹¹ AER, Draft Rate of Return Guideline Explanatory Statement, July 2018.

We should not be unnecessarily increasing these costs through regulatory and policy uncertainty. Access to low cost debt and equity is critical for all new energy investments, has stimulated investment in renewable technologies and enables prices to consumers to remain low.

Reducing the regulated return contrary to increasing risk will exacerbate adverse impacts on consumers

We need to ensure governance and independence remains strong and regulators properly consider the impact of decisions and actions in the long-term interests of consumers. In the absence of a robust and disciplined evaluation of impacts, energy consumers will pay more for less in the future. The cost to consumers could be significant, for example:

- **Increased reliability and security risk** – more than \$4 billion a year is required to invest in networks to keep “the lights on”. Operation of network businesses and their associated assets are not riskless, and in the absence of sufficient returns on investment, the risk associated with future supplies is likely to increase irrespective of the networks’ compliance with the licence conditions;
- **Higher bundled energy prices** – insufficient returns will put at risk critical and innovative investments that support a transition to a lower cost energy system, a transition that is being demanded by consumers. For example, AEMO’s Integrated System Plan (ISP) identifies that in the absence of significant transmission investment, consumers could miss out on more than \$1 billion in potential savings and that \$4 billion in wholesale resource savings may not be available from greater use of distributed energy resources and access to renewable energy zones.¹²
- **Value of lost load** - a 5% increase in the risk of additional unserved energy to consumers in NSW could result in lower reliability to consumers, which, if priced appropriately, would exceed the short-term reduction in retail prices that might be received from a lower rate of return.¹³

Moreover, as equity investors in Australian regulated networks have access to global investments, setting regulated returns at the bottom end of international comparators¹⁴ will likely starve the networks of incremental investment and reduce the pool of potential equity providers.

A proposal for a sustainable low-cost, low emission energy supply system

We are busy doing all we can within our part of the value chain to drive affordability, but the regulatory environment is creating uncertainty. We take a long-term view of our investments and we should not be alone in safeguarding the long-term interests of energy consumers in terms of price, reliability and security of supply of network services.

We consider the following objectives are critical to a successful transition to a lower cost energy network whilst protecting the long-term interests of consumers:

1. Reduce network costs whilst maintaining services.
2. Ensure efficient investment at the right time and in the right things.
3. Empower and support end use consumers to access the benefits of a competitive low-cost energy supply system.

¹² AEMO, Integrated System Plan, July 2018, p.6.

¹³ Network Shareholders Group, Response to the draft Rate of Return Guideline, 25 September 2018.

¹⁴ John Earwaker, The AER’s Draft WACC Guideline: An International Perspective, September 2018.

Our proposed initiatives to deliver on these objectives are presented in the table below.

Objective	Strategy	Initiatives
Reduce network costs whilst maintaining services	Maintain a stable, predictable, and transparent regulatory framework independent of political influence.	<ul style="list-style-type: none"> • Maintain regulated rates of return unless there is a material change in market conditions and ensure any modifications are consistent with the change in market conditions. • Modify the binding rate of return legislation to re-instate full judicial review for rate of return decisions. • Periodical and independent review of the effectiveness of the AER. • Cost benefit analysis of new obligations and reviews. • Curtail government intervention and political influence on the regulatory framework and outcomes.
	Strengthen incentives for efficiency and innovation.	<ul style="list-style-type: none"> • AEMC to investigate strengthening incentives for cost efficiency and innovation (including 'totex') and financial support for new technologies and higher risk investments and projects. (Underway)¹⁵ • Privatised remaining electricity network businesses in the NEM.
Ensure efficient investment at the right time and in the right things to reduce the cost of the energy supply system	Remove barriers and subsidies for new investment to compete with incumbent generation and facilitate renewable energy resources to deliver a low-cost energy supply system.	<ul style="list-style-type: none"> • The Energy Security Board (ESB) to develop an executable plan for the ISP. (Underway)¹⁶ • This plan should include consideration of the investment environment and regulatory overlap as well as formalise the status of the ISP in the AER's regulatory investment test process.
	Support research and development of new technologies to improve operation of networks and facilitate a platform for behind the meter investments.	<ul style="list-style-type: none"> • Open Energy Networks is a joint initiative by Energy Networks Australia (ENA) and AEMO to improve the efficiency of development of and access to distributed energy resources and a platform for two-way energy flows. (Underway)¹⁷

¹⁵ AEMC, Economic Regulatory Framework Review, Promoting efficient investment in the grid of the future, July 2018.

¹⁶ ESB, Converting the Integrated System Plan Into Action, 21 September 2018.

¹⁷ AEMO and ENA, Open Energy Networks, Consultation on how best to transition to a two-way grid that allows better integration of Distribution Energy Resources for the benefit of all consumers, July 2018.

Objective	Strategy	Initiatives
Empower and support end use consumers to access the benefits of a competitive low-cost energy supply system.	Accelerate and support pricing reform.	<ul style="list-style-type: none"> • Stop government intervention to undermine more efficient network tariff structures. • Encourage network tariff reform and the pass through of the economic price signals to retailers. • Improve transparency of the contribution of supply chain costs in end user bills by separately reporting network prices and price changes.
	Remove cross subsidies in energy pricing and technology-based subsidies (eg. Solar PV feed-in tariffs, other incentives and subsidies for solar and batteries).	<ul style="list-style-type: none"> • Undertake an independent review (eg. Productivity Commission) of subsidies in the energy supply system, including to energy consumers. • Develop targeted policies to protect low income and vulnerable customers from price impacts and support to make informed choices in a transforming energy system.

Transmission and distribution networks are critical to price affordability; delivering low-cost, reliable renewable energy solutions and the transition to the energy networks that we need for the future. More efficient private investment in the sector is required and is needed to reduce prices.

Attached to this letter is a compendium of relevant facts, reviews and submissions for your information.

I welcome the opportunity to discuss this letter further with you and. Spark Infrastructure is willing to assist with any further supporting information you may require. I can be contacted on 0411 700 967.

Yours sincerely,



Rick Francis
Managing Director & CEO
Spark Infrastructure

Attachments:

- A Compendium of facts and relevant reviews relating to Australian energy networks
- Spark Infrastructure, Letter to the Hon Josh Frydenberg MP, 15 June 2018
- Network Shareholder Group, Response to the draft Rate of Return Guideline, 25 September 2018