

Chapter 3

The Ausgrid lease and critical infrastructure

The NSW Government's case for leasing Ausgrid

3.1 In addition to using the capital currently 'locked up' in both Ausgrid and Endeavour Energy to finance significant state infrastructure projects, the NSW Government maintained that the strategy contained in *Rebuilding NSW*, which is largely dependent on the finalisation of the lease process, will produce additional economic and social benefits. In particular, the NSW Government argued that the proceeds from the lease process, which are projected to reach \$20 billion, will place it in a stronger position to address the challenge of continued population growth and the consequent need for an increase in economic activity to support a larger population base. The NSW Government further observed:

The investment in infrastructure made possible by the *Rebuilding NSW* Plan will allow NSW to better manage the increase in population and economic activity that will occur over the coming decades. Rebuilding NSW will increase NSW's Gross State Product (GSP) by \$30.9 billion by 2035-36 (measured in 2013 prices); this is a real increase of 3.6 per cent above the level of GSP that would occur without the *Rebuilding NSW* plan. The increase in GSP comes from both a more efficient electricity network and also from the reinvestment of funds from the partial lease of electricity network assets into productive infrastructure.¹

3.2 In addition to a network price guarantee, which will commit the successful bidder to ensuring that total network charges will be lower in the financial year 2018-2019 than they were at 30 June 2014, the NSW Government also announced that the current requirements in relation to safety and reliability, which are mandated by state legislation, will continue to apply once the lease process is finalised.²

3.3 Apart from the wider benefits of 'unlocking' the capital contained in NSW's electricity distribution network – while simultaneously maintaining state ownership of critical state infrastructure at 51 per cent – the NSW Government argued that current consumer protections will be maintained or even enhanced. In particular, for example, a number of major protective mechanisms will be either newly enacted or increased in scope:

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- 1 Legislative Council of New South Wales Select Committee on the Leasing of Electricity Infrastructure, *NSW Government Submission to the Electricity Networks Leasing Inquiry*, 12 May 2015, p.6
https://www.nsw.gov.au/sites/default/files/miscellaneous/nsw_government_submission_to_the_electricity_networks_leasing_inquiry_12_may_15.pdf (accessed 15 April 2016)
 - 2 Legislative Council of New South Wales Select Committee on the Leasing of Electricity Infrastructure, *NSW Government Submission to the Electricity Networks Leasing Inquiry*, 12 May 2015, p.6

- **Electricity Price Commissioner:** The NSW Government appointed Professor Allan Fels, a former Chairman of the Australian Competition and Consumer Commission (ACCC), to the position of Electricity Price Commissioner. In that new role, Professor Fels will report to the Government on each transaction to confirm that these will not put upward pressure on network charges in the short, medium and long term. He will also be responsible for reviewing annual price guarantee statements, and will have the authority to refer any concerns or inconsistencies to either the AER or ACCC.
- **Continued Price Regulation:** AER, as the national regulator, will continue to determine network charges for all of NSW's electricity network businesses, and will continue to have the authority to enforce compliance with its determinations.
- **Reliability Standards:** The leased network businesses will continue to have a range of legislated obligations in respect of the safety and reliability of their distribution networks. These legislated obligations will remain in place irrespective of ownership.
- **Terms of the lease:** As an additional safeguard, the lease can be terminated for a number of substantive reasons, including the following: failing to operate or maintain the network in accordance with the regulatory regime and good operating practice; the network ceases to be used as an electricity network; the insolvency of the lessee; the revocation of a major authorisation, such as National Electricity Market (NEM) registration or the NSW operating licence. The NSW Government's consent is also required in the event that there is a change in the control of the lessee.
- **Independent Safety and Reliability Regulator:** An Independent Pricing and Regulatory Tribunal (IPART) will be appointed to ensure the operator's compliance with licence conditions, along with the continued maintenance of the mandated safety and reliability standards. IPART will receive regular reports in relation to reliability and customer service standards. In addition, it will require annual independent audits of reliability and customer service standards, and IPART will have the authority to appoint inspectors to assess electrical installations and equipment. IPART's inspectors will also possess the authority to investigate serious electricity accidents.
- **Step in Rights:** The NSW Government, through the Energy Minister, will have the authority to trigger new 'step in rights' if a breach of licence or regulatory obligation threaten the safety, security or reliability of the state's electricity supply. Under this power, IPART will take on the role of network administrator and will appoint a 'step in operator' until the Minister determines that these interim measures can be dispensed with.³

3 Legislative Council of New South Wales Select Committee on the Leasing of Electricity Infrastructure, *NSW Government Submission to the Electricity Networks Leasing Inquiry*, 12 May 2015, p.5.

3.4 On the basis of these regulatory safeguards, some of which go beyond the current safety, reliability and consumer protection requirements, the NSW Government maintained that the lease of 49 per cent of the state's electricity network will achieve dual aims: maintaining an efficient, safe and reliable electricity distribution network while also ensuring that government services, both now and into the future, can meet the various needs of the state's growing population.

The Ausgrid lease and critical infrastructure protection

3.5 Since the NSW Government announced the formal commencement of the Ausgrid lease process in November 2015, some media reports, so far unconfirmed by the NSW Government, have suggested that a number of foreign energy and investment companies have expressed their interest in acquiring 50.4 per cent of the electricity distributor. In particular, some recent reports have suggested that, along with other major foreign companies and consortiums, two of the frontrunners in the lease process are State Grid, a Chinese state-owned energy supplier, and Cheung Kong Infrastructure, a Hong Kong-based investment vehicle and infrastructure operator.⁴

3.6 It has been reported that State Grid submitted one of the unsuccessful bids for the 99 year lease of Transgrid, with some commentators suggesting that its ultimate failure to secure the transaction was the direct result of significant national security concerns. The majority of these concerns reportedly relate to the importance of Transgrid as an element of Australia's critical infrastructure and the fact that State Grid is a Chinese State-owned Enterprise (SOE).⁵

3.7 In the course of its inquiry, the committee heard evidence, including from the Australian Strategic Policy Institute (ASPI), that Australia's critical infrastructure assets, including major electricity distributors like Transgrid and Ausgrid, are particularly vulnerable to a variety of forms of interference and sabotage, including through foreign cyber intrusion. ASPI expressed its concern that any sale or lease of these assets, especially to foreign SOEs like State Grid, could lead to potentially significant national security risks, many of which are not adequately addressed through the current foreign investment review process.⁶

3.8 In addition to the general risks associated with allowing foreign-owned companies or consortiums to own and operate critical infrastructure, ASPI highlighted the fact that the majority of Chinese SOEs, including State Grid, maintain very close links with the ruling Communist Party of China (CPC). This could have the effect of

4 Angela MacDonald-Smith, 'Ausgrid lines up as 'plan b' for losing Transgrid bidders', *The Sydney Morning Herald*, 23 November 2015, <http://www.smh.com.au/business/energy/ausgrid-lines-up-as-plan-b-for-losing-transgrid-bidders-20151122-gl5881.html> (accessed 18 April 2016).

5 Sean Nicholls, 'Transgrid lease reaps more than \$10 billion for NSW Government', *Sydney Morning Herald*, 25 November 2015, <http://www.smh.com.au/nsw/transgrid-lease-reaps-more-than-10-billion-for-nsw-government-20151124-gl77pc.html> (accessed 18 April 2016).

6 Australian Strategic Policy Institute, *Supplementary Submission 4.1*, p. 4.

turning these entities from purely corporate actors into little more than strategic instruments of the CPC, even though they continue to operate in the global free market.⁷ ASPI suggested that the close and ambiguous relationship between the CPC and SOEs does not appear to be sufficiently or effectively captured in the Australian Government's foreign investment review and assessment processes.⁸

3.9 ASPI also observed that, while all online systems are vulnerable to cyber-attack and intrusion, which can be launched from almost any part of the world, physical access to critical systems is likely to provide a malicious actor with a number of significant advantages, especially if the aim is to destroy or degrade a piece of critical infrastructure. Mr Peter Jennings, Executive Director of ASPI, pointed out that direct access can be an important facilitator of cyber intrusion and terrorism:

Complex networked systems by definition are linked and present a variety of interfaces that can potentially be accessed by aggressors seeking to damage those systems. Even systems that are completely air gapped -- that is, are physically isolated from the Internet -- still require some form of interface from which to be programmed and/or controlled. These systems can still potentially be attacked by malicious cyber actors, for example via thumb drives or direct programming through access to a control interface... As a developed country and a close defence and intelligence ally of the United States Australian critical infrastructure is also likely to be of high interest to potential cyber aggressors. All of this points to the importance of sales or leasing of critical infrastructure to be carefully assessed from the perspective of the vulnerability of the infrastructure in question to cyber - attack.⁹

3.10 In addition, ASPI also gave evidence to the committee that the NSW electricity distribution network, of which Ausgrid is a major part, constitutes a major component of national critical infrastructure, and is therefore not merely a matter of state government concern.¹⁰ In particular, ASPI suggested that:

The Committee should note that the NSW 'poles and wires' network is as vulnerable to cyber-attack as the US electricity distribution network or the networks of other countries. Moreover there is increasing interest on the part of malicious cyber actors to explore how to damage the critical infrastructure of potential opponents. Australia cannot isolate itself from these international developments...NSW's electrical transmission and distribution system is an element of critical infrastructure on which significant parts of the Federal Government, Defence and Intelligence

7 Australian Strategic Policy Institute, *Supplementary Submission 4.1*, p. 1.

8 Australian Strategic Policy Institute, *Supplementary Submission 4.1*, p. 1.

9 Mr Peter Jennings PSM, answer to question on notice, 10 March 2016 (received 1 April 2016), p. 1-2.

10 Australian Strategic Policy Institute, *Supplementary Submission 4.1*, p. 2 .

community relies. We cannot afford to be casual about the security of this critical infrastructure.¹¹

3.11 While the committee recognises that the NSW Government has put in place a range of protections, both in relation to network reliability and consumer protection, in order to ensure that the lease process does not produce adverse effects, the question of the risks posed by foreign control of critical infrastructure does not appear to have been directly or adequately addressed.

3.12 The flaws in the foreign investment review process that the committee identified in its substantive report, especially in relation to the transparency and consistency of the assessment process itself, mean that it is unclear whether the full implications of leasing 49 per cent of the state's electricity distribution network, possibly to foreign domiciled and controlled companies, has received sufficient critical assessment.

Committee view

3.13 The committee recognises that foreign investment proposals are often complex and sensitive, especially if the proposed investment is in a major national asset, such as Ausgrid or S. Kidman and Co. Nonetheless, much of the evidence provided to the committee during its inquiry suggests that the foreign investment review framework suffers from a lack of clearly defined processes. In particular, the national interest test is seemingly ad hoc and inconsistently applied.

3.14 The committee takes the view that the lease of Ausgrid and the sale of S. Kidman and Co. together serve as a case in point. In both cases, the assessment process appears to have been conducted in a seemingly arbitrary manner and without a clear presentation of a national interest argument.

3.15 The committee recognises that both the lease of Ausgrid and the sale of S. Kidman and Co. might be in the national interest. However, the lack of procedural clarity in relation to assessment criteria and the national interest test, which the committee noted in its substantive report, again strongly suggests that the Australian public cannot have full confidence that these investment proposals have been subjected to a rigorous, transparent and consistent assessment process. As the committee made clear in its substantive report, these inconsistencies weaken the overall effectiveness of Australia's foreign investment review framework, not only in the eyes of the Australian people, but also for potential foreign investors.

Senator Chris Ketter

Chair

11 Australian Strategic Policy Institute, *Supplementary Submission 4.1*, pp. 3-4.

