Response to ElectraNet:

Preliminary Revenue Proposal

From: Uniting Communities

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Response to ElectraNet, Preliminary Revenue Proposal

Uniting Communities welcomes the opportunity to respond to the preliminary revenue proposal, 2019 – 2023 that has been released by ElectraNet. We believe that the process of consumer engagement leading up to and incorporated in the release of this preliminary proposal demonstrates significant leadership by ElectraNet.

Process and acknowledgements

In responding to this preliminary revenue proposal we place on record our congratulations to ElectraNet for their sincere attempts to actively engage with a range of stakeholders, including small end use consumers, in planning to lodge their regulatory proposal early in 2017. We regard this "early engagement" approach to be a significant development in approaches to consumer engagement for regulatory proposals by utility network businesses in Australia. Uniting Communities has played an active role on the consumer advisory panel that was established by ElectraNet in the mid-2015 and has been a member of the working group that has been set up to look at some aspects of the revenue proposal, in greater detail.

Uniting Communities notes that we are committed to seeing a shift in regulatory processes in Australia from adversarial and litigious approaches to processes involving deliberation and negotiation directly between consumer interests and networks, within the national electricity rules. We supported UnitingCare Australia to release a discussion paper in June 2015 titled "Towards a DNA approach[1]", where DNA refers to "deliberation", "negotiation" and "agreement". We have received funding through energy consumers Australia to further explore application of what we have termed DNA approaches. This has included us participating as a consumer group in engagement with ElectraNet.

The following brief notes respond to the preliminary revenue proposal, September 2016.

Section 2: leadership in consumer engagement

We agree that ElectraNet is "leading the industry with (their) early engagement approach" and believe that the approach is highly constructive. It is our opinion that ElectraNet has engaged with sincerity and goodwill which we regard as extremely important. Of course it does not mean that we will agree with all findings or proposals that ElectraNet puts in its final revenue proposal. But we believe that the early engagement and broader consumer engagement approaches have reduced the number of areas where differences of opinion are likely and as such has saved ElectraNet and consumer's; time, money and some 'angst'!

Section 3: transitioning to a low carbon economy

South Australia is at the forefront of global change in the energy sector in particular regarding integration of renewable energy generation into the electricity grid, through transmission connections. For example, on 24/11/16 Australian energy Council[2] wrote about "South Australia pioneering Australia's energy transformation." On the 6/11/16, Renew Economy[3] wrote "South Australia stands at the forefront of the renewable energy transition". We agree that wind and solar

[1] Now available on http://noshockenergy.org/changing-dna-network-tariff-setting-australia/
[2] https://www.energycouncil.com.au/analysis/south-australia-pioneering-australia-s-energy-transformation/
[3] http://reneweconomy.com.au/how-electricity-storage-will-help-drive-south-australias-renewable-transition-98859/

energy both small-scale photovoltaic cells and larger scale solar (including solar storage) generation are already significant for the South Australian electricity generation mix and are likely to become more significant into the future, with gas-fired and some diesel generation backup.

Is our observation that South Australia is a world leader in transitioning to a low carbon economy and so is dealing with the difficult aspects of this transition earlier than other jurisdictions and this consequently has significant challenges at political as well is engineering level. We also believe that solving these transition issues will leave the South Australia economy well placed in the medium to longer term and also provide real potential for the export of energy services that are related to integration of renewable electricity supply into the grid.

There is been considerable debate in Australia over recent years about the future of the grid with some arguing that the ever reducing costs of photovoltaic cells and battery storage means that growing numbers of people will go "off grid". This is been the subject of a major piece of work involving Energy Networks Australia and the CSIRO[4], the report basically concludes that there is a positive long-term future for the electricity grid in Australia and in particular for transmission services. We are a little surprised that ElectraNet has not drawn more heavily on this body of work and the conclusion about the high likelihood of long-term viability for transmission network services.

We understand that there are significant reliability questions with integration of higher levels of renewable generation into the grid including frequency reliability as well as reliability of supply issues. We are consequently a little surprised at the lack of mention of maintaining frequency reliability in the transmission system in the preliminary revenue proposal. We recognise that reliability of supply (generation) issues were highlighted by major storms that hit Adelaide after this preliminary revenue proposal was released. We do not believe that the storms and associated damage changes the issues raised in the revenue proposal. We also recognise that nine (that we are aware of) independent reviews have been undertaken or are currently underway and some of these are likely to be making recommendations that will impact on ElectraNet.

It remains an imperative that any spending arising from the various proposals from these review recommendations are only implemented where they are efficient and do not require end customers to be paying any more than is absolutely necessary. This applies to current and future consumers.

4. Strong, reliable and more interconnected transmission network

We recognise that transmission accounts for about 10% of the average 'small consumer' electricity bill, and some do not regard this as significant. However as an agency dealing with people struggling to pay their electricity bills on a daily basis, there is an imperative for electricity bills being reduced for residential as well is business customers, at every possible level in the price stack. Transmission certainly has a role to play in reducing total costs paid by consumers, as do all other elements of the electricity supply chain.

It is noted that in section 4.2 of the Preliminary Revenue Proposal (PRP) that the view is posited that greater interconnection is needed between South Australian and interstate electricity markets. We do not believe that the PRP argues this case decisively, whilst we are not opposed to additional interconnection we are not convinced at the moment that the long-term cost burden on future consumers associated with additional interconnection is warranted. Further interconnection may be a long-term solution to a short-term problem. We recommend that this section of the ElectraNet's

[4] http://www.energynetworks.com.au/electricity-network-transformation-roadmap

proposal canvases further potential solutions other than greater interconnection and includes non-network options.

We note that figures provided in the preliminary revenue proposal show that ElectraNet is a relatively efficient transmission business given the relatively small population that it serves and when compared to other transmission businesses. We would prefer to be able to see independent benchmarking data for transmission businesses in Australia, but recognise that this is not readily available. Whereas the Australian Energy Regulator is able to provide good quality benchmarking data for distribution businesses.

5 Consumer Engagement

As we have said in the introduction, we have actively supported the ElectraNet approach to consumer engagement and recognise the importance of end customers being part of consultation with ElectraNet because even though they do not have direct contact with transmission service providers, consumers still pay for ElectraNet services in the bills they pay.

We are happy with the directions and priorities that are summarised in section 5.3

6. Business efficiencies

We commend ElectraNet on their efforts to achieve greater efficiencies in their business.

7. Transmission prices

It is heartening that the proposed initial nominal price reduction is for about 13% in moving from 2017-18, the end of the current regulatory period, to 2018-19 the start of the next revenue period. However in considering figure 14 the indicative transmission price path shows an increase of about 20% nominal, cents per kwh over the five years of the regulatory control period. This increase is greater than current inflation forecasts and is not in line with the expectation of Australian regulatory frameworks which are predicated on a (CPI – X) incentive-based regulatory model where X is an efficiency dividend to pass onto consumers and to provide incentive to network businesses for greater efficiency year-on-year. It would appear that ElectraNet is proposing a (CPI +X) price path from the first year of the regulatory period, which we do not regard as reasonable.

8. Capex

The headline reduction of 46% in capital expenditure is significant. It is our understanding that two RiT-T processes are likely in the near future; consideration of further interconnection between the South Australian and New South Wales grids, this is already well underway and then a second RiT-T process to consider upgraded connection between Port Lincoln and Whyalla. While not directly reported in the capital expenditure program for which revenue is sought in this proposal, these two large projects, if approved, would have the effect of significantly increasing capital expenditure on the transmission network operated by ElectraNet

Unfortunately we have not had the opportunity to give greater consideration to the individual elements of the proposed capital expenditure program, but on 'first pass' considerations, these seem reasonable.

9. Opex

Again, the headline reduction rate, in this instance 10%, seems reasonable from an end consumer perspective, but we have been unable to assess individual items of expenditure. We support the year 2015-16 as being a reasonable base year for opex costs for subsequent years.

10. Building block / cost of capital

10.1 Depreciation

We are surprised that regulatory depreciation accounts for about 23% of revenue for 2019-23. We have not had the opportunity to explore the question as to why the RAB, regulated asset base, is increasing over this regulatory period given a substantial reduction in capital expenditure. We are not in a position to comment on this element of depreciation accounting for about $42 million (nom) over the regulatory period. Similarly we have not looked at the 'shorter life assets' which account for 15 million and are not convinced of CPI of 2%, we suggest a CPI is nearer 2.4% - 2.5%. This aspect of the PRP would benefit from further discussion with consumer interests, prior to final lodgement of the proposal with the AER.

10.2 Return on capital

We assumed that ElectraNet is applying the SL-CAPM approach for return on capital as per the AER better regulation guidelines. We support the application of this CAPM approach.

We suggest that the financial parameters proposed by ElectraNet are "around the mark" however we would be looking for the following, preferable parameters; Electra net's PRP values are given in brackets:

- risk-free rate (2.32) we suggest 2.00
- equity beta (0.7) we suggest 0.5, this being the midpoint of the range of values for beta, estimated by Olan Henry, 0.3-0.7 in his analysis for AER[5]
- market risk premium (6.5) we suggest 6.0
- return on debt (4.98%) we accept this figure
- gearing ratio (60%) we accept this figure

Note: return on equity and nominal vanilla WACC will change from those proposed in the PRP, but we haven't calculated them.

10.3 Corporate Tax imputation credits: gamma

We believe that the value for gamma should be 0.5 rather than the 0.25 proposed in the PRP, but others have argued this case and we will not repeat the arguments here, recognising that this is a contentious issue which is being considered by the limited merits review and is currently being considered by the Federal Court.

10.4 forecast inflation

Our view is that a more appropriate inflation figure for the regulatory period is 2.4%, just below the midpoint of the Reserve Bank of Australia's target range for inflation of 2% - 3%. It seems we are a

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[5] https://www.aer.gov.au/system/files/Henry%20%E2%80%93%20%20Estimating%20Beta%20%E2%80%93%20An%20update%20%E2%80%93%20April%202014_0.PDF

little more optimistic about the South Australia economy over the next five years than is ElectraNet with their 2% inflation forecast.

10.5 incentive arrangements

We have not yet had the opportunity to go through these in any detail but accept that ElectraNet is applying each of STIPIS, EBSS and CESS in line with AER has current guidelines, which we regard as eminently reasonable.

11. Other feedback.

We regret that circumstances have limited our capacity over the last couple of months to engage with responding to this preliminary regulatory proposal in greater detail, however we will do so as best as we can in the coming months.

We anticipate that at time of lodgement of their revenue proposal in January 2017[6], ElectraNet will back up some of the elements of their regulatory proposal with studies or research from consultants and academics. If this is the case, we have not had the opportunity to consider these but would still anticipate that any additional evidence that ElectraNet may present would be still be in line with the key parameters presented in the PRP and would not have impact on the amount of revenue sought through the regulator.

Our earlier comments are also reiterated whereby we commend ElectraNet for the approach taken in pioneering the release of a preliminary revenue proposal and being open to scrutiny and discussion. We welcome the opportunity for further discussion with ElectraNet in the lead up to lodgement of their regulatory proposal and in working through consideration of the proposal, in accordance with the national electricity rules, by the AER.

Conflict of Interest considerations

The lead author of this submission is Mark Henley who is also a member of the AER's Consumer Challenge Panel (CCP). Mark is not a part of the CCP sub-panel that will be considering the ElectraNet revenue proposal.

[6] We accept the AER decision to extend the lodgement date to the end of March 2017, noting the significant impact on ElectraNet of the SA storms of late September 2016, including the state-wide blackout on 28th September.