8 November 2017

ElectraNet

AER Draft Decision Outcomes & Implications

Consumer Advisory Panel

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Purpose

> Brief the Panel on the outcomes of the AER's Draft Decision on ElectraNet's Revenue Proposal, released on 26 October 2017

> Discuss implications and focus areas for responding to the Draft Decision based on initial analysis, pending more detailed review

> Share indicative revised revenue proposal estimates with the Panel for discussion

Draft Decision Overview (1)

Component	Outcome	Details
Regulatory Asset Base (RAB)	Accepted	• Updated for inflation and other adjustments
WACC	Accepted	• Placeholder estimate updated (from 6.02% to 5.75%) for prevailing market rates
Gamma	Not accepted	• Gamma revised (from 0.25 to 0.40) reflecting prevailing AER approach and appeal outcomes
Inflation	Not accepted	• Inflation forecast revised (from 1.97% to 2.5%) based on prevailing AER approach, pending outcomes of current review
Regulatory Depreciation	Accepted	• Updated inflation forecast increases RAB indexation and reduces regulatory depreciation (over $60m or 17%) • Line refit life of 27 years extended to 48 years • Synchronous condenser asset class not accepted – to be considered as needed

Draft Decision Overview (2)

Component	Outcome	Details
Capital Expenditure	Accepted	• Forecast updated for inflation • Some specific aspects not supported (e.g. Gawler East project) but total forecast approved based on its overall reasonableness
Contingent Projects (x5)	Accepted	• Minor clarifications to trigger events
Operating Expenditure	Accepted	• Forecast updated for inflation • Forecast found to be well below AER benchmark forecast ($34m or 8%) • Expectation of changes based on recent cost pressures noted
Corporate Tax	Accepted	• Forecast updated for gamma and overall revenue reduction, reducing tax allowance ($42m or 53%)
Efficiency Benefit Sharing Scheme (EBSS)	Accepted	• Minor adjustment to carry forward payments ($200k) • Exclusions in forecast EBSS revised

Draft Decision Overview (3)

Component	Outcome	Details
Capital Expenditure Sharing Scheme (CESS)	Accepted	• To apply in coming period
Service Targets & Network Capability Incentive Parameter Action Plan (NCIPAP)	Accepted	• Minor adjustments to targets (caps and collars) • NCIPAP revenue removed from headline forecast
Pricing Methodology & Negotiating Framework	Accepted	• No changes
Revenue	Reduced	• Overall revenue reduction ($150m or 9%) due to updated WACC, inflation, gamma & NCIPAP reporting
Customer Price Impact	Improved	• Increase in up front reduction per household (from $14 to $22 pa) due to overall revenue decrease

Reflections on Consumer Engagement

"ElectraNet has undertaken an extended, open and well-structured program that has made a positive contribution to the development of ElectraNet's proposal… ElectraNet's consumer engagement for this revenue proposal has led the way and establishes one of the best practices we have seen from network service providers."

- *Australian Energy Regulator, October 2017*

"CCP9 commends ElectraNet for taking on the challenge of engaging customers in the preparation of its revenue proposal, particularly given the difficulties that transmission companies face in undertaking meaningful engagement. We also commend ElectraNet for its commitment to a 'no surprises' approach and the sustained commitment of senior management to its CE program even when facing significant external challenges.

While there are areas for improvement, we consider that on the whole ElectraNet's CE sets the current benchmark for other TNSPs."

- *Consumer Challenge Panel, July 2017*

Priorities for Response

Focus areas for Revised Revenue Proposal

Component	Proposed response
WACC outcomes (including gamma and cost of debt approach)	Accept the Draft Decision – in line with feedback from stakeholders to accept prevailing approach to gamma and cost of debt
Capex forecast	Accept the Draft Decision
Inflation	Maintain existing method pending final outcomes of AER inflation review (final decision due December 2017)
Opex forecast	Correct calculation of benchmark debt raising costs, add a step change for the impacts of the new obligations imposed on the business since the Revenue Proposal, and make any other minor required updates and corrections to the forecast
Other	Submit any other updates or adjustments required (e.g. further refinement of contingent project triggers)

Operating Expenditure - Overview

- Draft Decision accepted proposed operating expenditure forecast of $440m ($2017-18)
- AER found prudent and efficient benchmark forecast to be $474m ($2017-18) or $34m more
- AER notes it expects changes in ElectraNet's proposed expenditures arising from recent reviews that have occurred since submission of ElectraNet's Revenue Proposal (as reflected in ElectraNet's advice to stakeholders on 6 October 2017)
- An error was also found in ElectraNet's calculation of the benchmark debt raising cost forecast

Debt Raising Costs

> Debt raising costs are the transaction costs incurred each time a business raises or refinances debt

> These costs are forecast on an efficient benchmark basis, consistent with how the cost of debt is forecast

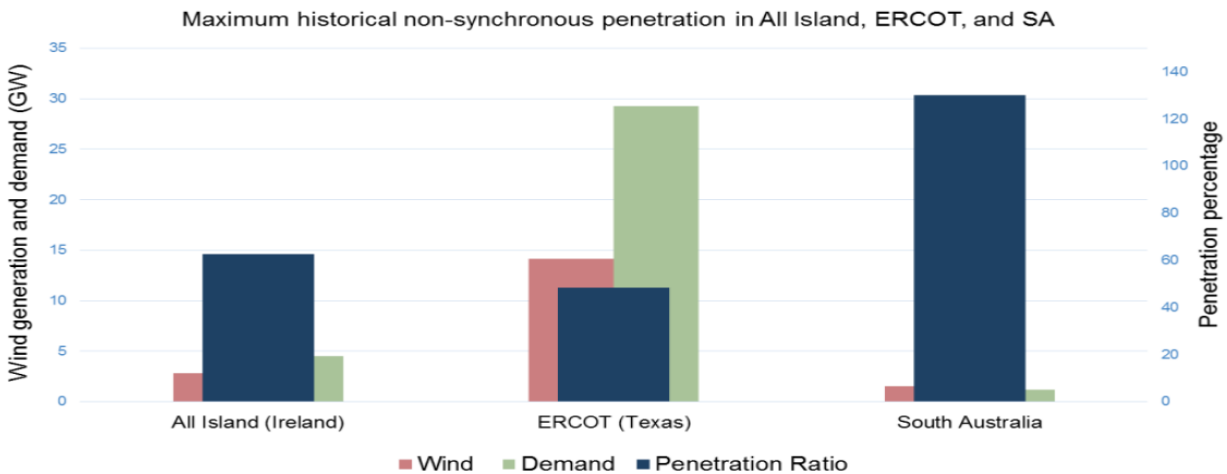
> The Revenue Proposal applied the AER's benchmark approach to forecast debt raising costs, relying on the information contained in the revenue model published by the AER

> The AER accepted this forecast ($0.8m), but calculated its own estimate ($6.3m) – indicating ElectraNet's estimate was incorrectly calculated

> ElectraNet will correct its calculation in the Revised Revenue Proposal to accurately reflect the AER's efficient benchmark cost estimate

System Security Challenges Driving New Obligations

> The challenges seen in SA in relation to low levels of synchronous generation are a first in any large scale power system in the world…



Source: AEMO, South Australian System Strength Assessment, September 2017

> SA is unique compared with other major systems with high levels of wind:

Denmark – has many interconnections with neighbouring countries

Ireland – restricts non-synchronous generation to 55% penetration levels

Germany – has many interconnections with neighbouring countries

Texas – has low levels of wind relative to system demand

Cost Pressures from New Obligations

- The Revenue Proposal highlighted the system security challenges facing South Australia, and the possibility of additional resource impacts from the actions being taken in response, noting the range of reviews and Rule changes under way at the time
- A number of new obligations have since been imposed on the business, not all of which can be absorbed within existing resource limits
- These include requirements for National Grid Planning, maintaining levels of inertia and system strength in the power system, and new and additional reporting and disclosure obligations
- These are currently expected to have a net cost impact of around $2m per annum, which will not have a material impact on overall pricing outcomes, but is significant to ElectraNet’s resource base and its ability to deliver service outcomes for customers

New Obligations – Implications (1)

Development	New Requirements	Benefits & Risks to Customers
National Grid Planning	An integrated grid plan to be developed by AEMO and TNSPs, including renewable energy zones supported by new transmission route and interconnector options	Integrated grid development enables efficient location of renewable generation investment across the NEM to support energy security, reliability and affordability for customers
Managing Power System Fault Levels Rule & Managing Rate of Change of Power System Frequency Rule	New obligations for TNSPs to maintain levels of system strength and inertia on the power system	These services are essential for the secure operation of the power system in the face of a changing generation mix
Transmission Connection & Planning Arrangements Rule	Obligations for TNSPs to provide additional network connection information to enable competition in the connection process	Contestability helps maintain downward pressure on connection costs, flowing through to delivered energy costs for customers

New Obligations – Implications (2)

Development	New Requirements	Benefits & Risks to Customers
Replacement Expenditure Planning Arrangements Rule	Obligations for greater rigour, scrutiny and transparency by TNSPs in asset replacement decision making	Ensures efficient risk-based approach to asset replacement to help drive lowest long-run cost outcomes for customers
Generating System Model Guidelines Rule	Strengthened requirements for provision of modelling data by connecting generators and analysis by TNSPs	Enables more complex modelling to help maintain system strength and ensure the secure operation of an evolving power system
ESCOSA SA Generator Licensing Arrangements	Technical conditions to be met by new generators connected to the SA network by ElectraNet	Needed to ensure a secure and resilient power system for customers in the face of an evolving generation mix
Emergency Frequency Control Schemes Rule	Establishes a new framework for AEMO and TNSPs to review emerging power system frequency risks and implement appropriate controls	These controls are essential to maintain security of supply for customers in a changing power system environment

New Obligations – Indicative Impacts (1)

Cost Driver ($m Real)	Up front Costs Absorbed[(1)]	Indicative Annual Costs[(2)]	Indicative additional resource impact
National Grid Planning	0.3	0.4	• Additional specialist resources to provide input and analysis to development of the National Grid Plan and associated planning work
Managing Rate of Change of Power System Frequency Rule & Managing Power System Fault Levels Rule	0.2	1	• Software licencing fees • Additional specialist resources for model development and maintenance, new modelling capability, and ongoing fault protection system review
Transmission Connection & Planning Arrangements Rule	1.4	0.4	• Up front effort to revise and publish connection standards • Ongoing effort for maintenance of additional standards and publication

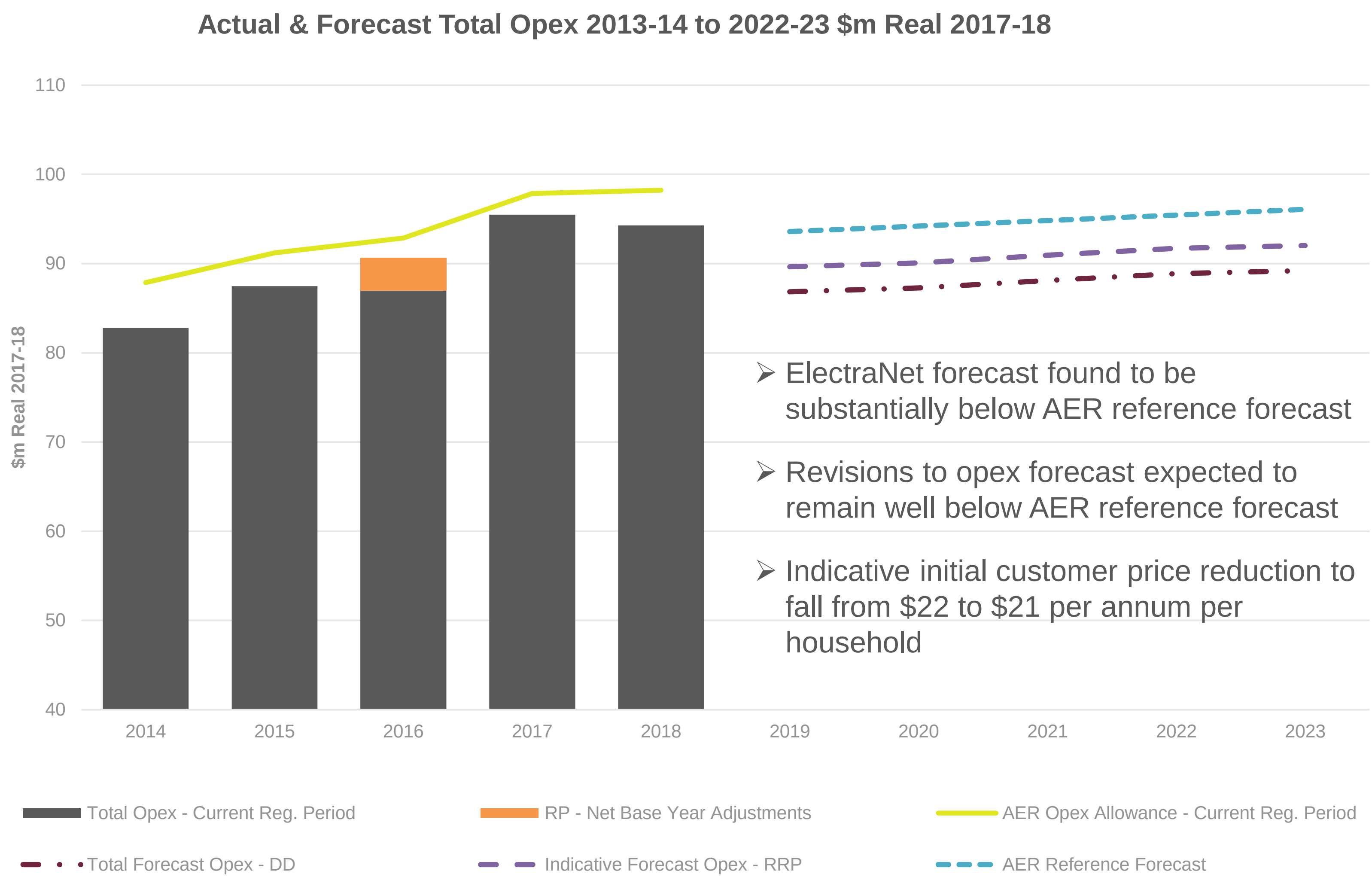
(1) Reflects up front Opex costs to be incurred in 2017-18 to ready the business to manage the new obligations
(2) Quantification of ongoing incremental resource impacts based on total annual labour cost for specialist professional roles as reported in the annual Regulatory Information Notice

New Obligations – Indicative Impacts (2)

Cost Driver ($m Real)	Up front Costs Absorbed[1]	Indicative Annual Costs[2]	Indicative additional resource impact
Replacement Expenditure Planning Arrangements Rule	0.1	0.4	• Up front effort to revise and develop the RIT-T approach for investment planning • Incremental resources to maintain more rigorous approach to risk cost assessment for capital and operating projects • Manageable resource impact from additional TAPR reporting
Generating System Model Guidelines Rule			• Cost impacts absorbed
ESCOSA SA Generator Licensing Arrangements			• Cost impacts absorbed
Emergency Frequency Control Scheme Rule	0.1	0.2	• Specialist resources for analysis of power system frequency risk and control schemes
TOTAL	**2.1**	**2.4**	

(1) Reflects up front Opex costs to be incurred in 2017-18 to ready the business to manage the new obligations
(2) Quantification of ongoing incremental resource impacts based on total annual labour cost for specialist professional roles as reported in the annual Regulatory Information Notice

Indicative Opex Outlook



- ElectraNet forecast found to be substantially below AER reference forecast
- Revisions to opex forecast expected to remain well below AER reference forecast
- Indicative initial customer price reduction to fall from $22 to $21 per annum per household

Timetable

Item	Due Date
Revenue Proposal lodged with AER	28 Mar 2017
Issues Paper released by AER	25 May 2017
AER Public Forum	7 Jun 2017
Consultation closes on Revenue Proposal	7 Jul 2017
AER to publish Draft Determination	26 Oct 2017
AER Public Forum	6 Nov 2017
Deadline for Revised Revenue Proposal	2 Jan 2018
Submissions on Draft Determination & Revised Proposal due	29 Jan 2018
AER to publish Final Determination	30 Apr 2018

Questions