

6 October 2017

Paula Conboy
Chair
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

By email: paula.conboy@aer.gov.au

Dear Ms Conboy

Re: ElectraNet's Revenue Proposal 2019-2023 – Update on Cost Pressures

The AER is currently reviewing ElectraNet's Revenue Proposal covering the 5-year period commencing 1 July 2018.

The purpose of this letter is to update the AER and stakeholders on recent developments that have occurred since we lodged our Revenue Proposal and their likely resource impacts and operating expenditure cost implications for ElectraNet in efficiently managing the network.

Background

ElectraNet faces a unique set of circumstances given the significant external challenges facing the electricity supply industry in South Australia, and measures progressively being put in place to address these issues.

These challenges are clearly evident through the impact of the storm events of 28 September 2016 and the numerous inquiries and rule change proposals that were underway at the time we lodged our Revenue Proposal.

A central focus for these inquiries and reviews is the importance of ensuring system security as the energy market transitions to more distributed generation, lower emissions intensity and greater flexibility, driven by new technologies and changing customer preferences. System security exposure is heightened in South Australia, given its limited interconnection with other regions and the high levels of intermittent renewable energy penetration.

The circumstances surrounding the development of our Revenue Proposal created unprecedented uncertainty, especially in setting our expenditure forecasts.

In relation to capital expenditure, in consultation with our stakeholders we revised our preliminary forecasts upwards to include a small number of prudent and targeted investments designed to improve system security and network resilience. We also included two contingent projects that may be triggered by system security measures.

While we made modest upward adjustments to our capital expenditure forecasts, our operating expenditure forecasts were unchanged from our preliminary revenue proposal based on the information available at that time. In addition, both our operating and capital expenditure forecasts were necessarily based on the prevailing service requirements, standards and obligations for safety, security and reliability.

Our Revenue Proposal, however, made it clear that the various inquiries and reviews could lead to changes in our responsibilities, particularly in relation to system security. This matter was also raised during our meeting with the AER Board and Management as part of our Revenue Proposal overview presentation in Melbourne on 21 April 2017.

Recent Developments

Our Revenue Proposal highlighted a number of the reviews and inquiries into the system security issues facing South Australia and the wider NEM that were under way or pending at that time.¹ The table in the Attachment provides an updated summary of the key reviews and rule changes and possible resource implications.

In particular, the following AEMC reviews and rule changes are now complete and we have a better understanding of their resource implications, as set out below:

- AEMC System Security Market Frameworks Review

This review has led to a new obligation under the Rules for TNSPs to provide minimum specified levels of inertia and system strength, or alternative equivalent services. The resource implications include the need for additional modelling capability, analytical capacity and specialist system planning resources and associated software systems to ensure that ElectraNet discharges its new obligations effectively. In addition, resources associated with the procurement and administration of these new services will be required.

- Transmission Connection & Planning Framework Rule Change

This rule change requires ElectraNet to redesign its transmission connection planning process to facilitate contestability in the provision of dedicated connection assets. These obligations will impose additional costs on the regulated business to ensure that staff and information are appropriately quarantined from competitive market activities. New obligations and resource requirements also arise in relation to the ongoing publication of additional network connection and planning information.

- Regulatory Investment Test for Transmission (RIT-T) Rule Change

This rule change extends the RIT-T to replacement capital expenditure. While the RIT-T does not require additional planning work, it requires additional analysis and assessment of solution options, and mandates consultation and the publication of information which is not currently required. ElectraNet will require additional resources to satisfy these new obligations, including ongoing reporting in its Transmission Annual Planning Report.

¹ ElectraNet, Revenue Proposal Overview 2019 – 2023, 28 March 2017, section 2.1, pp 8-9.

The resource and cost implications and outcomes of some reviews still remain unclear. For example, the full outcomes of the following reviews are still pending:

- The 'Finkel' Review into the future Security of the NEM, which was recently considered by COAG, provides a 'blueprint' for reform and may introduce further system security and planning measures (for example the development of a Grid Plan by AEMO which will require a significant contribution from ElectraNet); and
- AEMC Review of the System Black Event in South Australia, which has not yet commenced, and will report to Ministers on recommended actions or amendments to the regulatory framework to address any systemic issues identified as a result of the system black event.

ElectraNet strongly supports changes that promote better customer outcomes. However, it is important to recognise that ElectraNet will incur material additional costs in facilitating these improved outcomes, above and beyond those identified in our Revenue Proposal.

While not expected to have a material impact on overall revenue and price outcomes for customers, the collective additional resource impacts of recent developments identified above are likely to be significant to ElectraNet's operating cost structure, particularly in a low inflation environment.

Next Steps

ElectraNet remains focused on minimising costs to our customers, while also ensuring that we have the necessary resources in place to meet our current and new service obligations. With these objectives in mind, we intend to update our operating expenditure forecast when we submit our Revised Revenue Proposal in response to the AER's draft decision, which is expected in late October 2017. Our forecast will reflect our best estimate of the efficient and prudent costs of meeting our new responsibilities and compliance obligations.

In order to identify the net impact on efficient operating costs, ElectraNet is working to fully assess the additional resource requirements of these new obligations and explore opportunities to offset these through improved efficiencies.

Early information suggests the indicative additional net operating expenditure impact of these additional resource requirements may be in the order of \$1m to \$2m per annum.

In preparing our Revised Revenue Proposal, we will also give careful consideration to how best to manage the risks associated with uncertain obligations or reviews that are still on-going. For example, we will consider whether pass through arrangements may be available to manage any additional capital or operating costs associated with the procurement of system strength or inertia services, which are likely to remain uncertain in the short term.

Summary

ElectraNet appreciates that the evolving challenges of our external environment create a level of uncertainty for stakeholders and the business alike for our future expenditure requirements, which are facing upward pressure.

The purpose of providing early notification of our intentions in this letter is to provide stakeholders with as much notice as possible about these matters.

In summary:

- ElectraNet faces a unique set of circumstances given the specific system security challenges facing South Australia and actions that are being taken in response, coinciding with the timing of the revenue determination process;
- We highlighted the possibility of additional resource impacts in our Revenue Proposal and provided as much information as was available about the evolving developments and potential implications at that time;
- We will continue to work through these challenges with our stakeholders and provide any new or updated information as it becomes available, in keeping with our 'no surprises' commitment;
- We are working to review the resource implications of known developments and explore opportunities to absorb or offset the associated cost impact in order to minimise additional operating expenditure requirements, consistent with our 'no ambit claims' approach;
- While not expected to have a material impact on overall revenue and price outcomes for customers, the collective additional resource impacts of recent developments are likely to be significant to ElectraNet's operating cost structure in a low inflation environment; and
- Full details will be provided in ElectraNet's Revised Revenue Proposal, following further review and consultation on these new requirements and net resource impacts with ElectraNet's Consumer Advisory Panel at its next meeting on 8 November.

ElectraNet undertakes to keep the AER and stakeholders updated as further information on the cost implications of new obligations become available. Should you wish to discuss any aspect of this letter, please contact me on 08 8404 7983.

Yours sincerely



Rainer Korte
Executive Manager Asset Management

cc. Consumer Advisory Panel members

Attachment – Status of recent developments and potential resource implications

Recent developments	Current status	Scope and potential resource implications
AEMC System Security Market Frameworks Review	Final report published 27 June 2017. Initial rule changes finalised 19 September 2017.	<p><u>Scope:</u> To develop recommendations that will result in:</p> <ul style="list-style-type: none"> • A stronger system • A system better equipped to resist frequency changes • Better frequency control • Actions to further facilitate the transformation <p>On 19 September 2017, new Rules were made that require TNSPs to provide minimum specified levels of inertia and system strength, or alternative equivalent services, to allow the power system to be maintained in a secure operating state.</p> <p><u>Resource Gap:</u> ElectraNet will require additional resources to manage the new obligations arising from these rule changes. Significant operating costs may also be incurred in procuring the required levels of inertia and system strength, and potentially capital costs if a network investment is found to be an optimal longer-term solution.</p> <p>ElectraNet will also require additional modelling capability and analytical capacity for ongoing analysis of inertia and system strength as well as system planning and reporting. System upgrades and additional software licencing will also be required.</p>
Transmission Connection & Planning Framework Rule Change	Final Determination published 23 May 2017.	<p><u>Scope:</u> Improves transparency, contestability and clarity in the transmission connection framework and enhances the transmission planning and decision-making framework.</p> <p><u>Resource Gap:</u> The introduction of contestability in dedicated connection assets requires major changes to ElectraNet's current transmission connection process. The preparation and publication of new information on connecting to the network will also require additional resources.</p>
RIT-T for Repex Rule Change	Final Determination published 18 July 2017	<p><u>Scope:</u> To increase the transparency of network service provider plans to retire, de-rate and replace network assets by:</p> <ul style="list-style-type: none"> • Extending the scope of the RIT-T to replacement expenditure from 30 January 2018 • Including network asset retirement and de-rating information in TNSP's Annual Planning Reports from June 2018 <p><u>Resource Gap:</u> Increased resources will be required to apply the new RIT-T consultation process, assess alternative options, and publish additional planning information.</p>