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CCP25

## ElectraNet

Advice to the AER on the 2023 – 28  
Electricity Transmission Regulatory Revenue Proposal

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**AER Consumer Challenge Panel – Sub-Panel CCP25**

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### **Acknowledgement of country**

We recognise the traditional owners of the lands on which Transgrid and ElectraNet operate, as well as those where this report is being prepared. We respect the elders of these nations, past and present along with their emerging leaders.

### **Acknowledgements**

CCP25 wants to thank and acknowledge the staff from ElectraNet who have included us in their engagement activities in the late stages leading up to the Regulatory Proposal. We also extend our gratitude to the AER staff for their support and guidance throughout this process

### **Confidentiality**

We wish to advise that to the best of our knowledge this advice neither presents any confidential information nor relies on confidential information for the comments.

### **The Consumer Challenge Panel sub-panel CCP25**

The AER established the Consumer Challenge Panel (CCP) in July 2013 as part of its Better Regulation reforms. These reforms aimed to deliver an improved regulatory framework focused on the long-term interests of consumers.

The CCP assists the AER to make better regulatory determinations by providing input on issues of importance to consumers. The expert members of the CCP bring consumer perspectives to the AER to better balance the range of views considered as part of the AER's decisions.

CCP25 is a sub-panel of the AER's Consumer Challenge Panel. The AER established the sub-panel to focus specifically on the AER's revenue determination for both Transgrid (NSW) and ElectraNet (SA).

CCP25's brief is to provide advice to the AER on:

- whether the proposals are in the long-term interests of consumers, and
- the effectiveness of the businesses' engagement activities with their customers and how this engagement is reflected in the development of the proposals.

# 1 Executive Summary

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This submission responds to the revenue proposal from the ElectraNet electricity transmission business in South Australia for the period 1 July 2023 to 30 June 2028 (the **Revenue Proposal**) and the Issues Paper published by the Australian Energy Regulator on 28 March 2022 (the **Issues Paper**). ElectraNet submitted its Revenue Proposal on 31 January 2022, in preparation for the AER to publish a draft decision in September 2022 and a final regulatory determination by 30 April 2023.

The CCP25 was appointed on 19 November 2021. This was shortly before the Revenue Proposal was lodged and after most of the consumer engagement and decision making had occurred. This advice is therefore based primarily on our review of documents, rather than directly observing the engagement as it occurred.

Unlike its New South Wales equivalent Transgrid, ElectraNet has not provided an insight into the potential impact that the significant ISP-related and contingent projects – which alone could potentially add between \$180M and \$360M to the capital works programme and the Regulated Asset Base – may have on revenue and prices. Whilst this investment is outside the scope of the regulatory reset, we see it as important information for customers as a possible trend in prices, especially over the long term.

Our assessment of ElectraNet’s consumer engagement is that their commitment to consumer engagement was genuine, although it fell short in its execution at times due to delays and the complexities of virtual engagement environment. Their Consumer Advisory Panel Working Group was initially mostly at the lower (“inform” and “engage”) end of the IAP2 spectrum but progressed to a greater degree of co-design and more mature engagement in the later stages in the engagement program. In the limited time available, we observed a good engagement culture, a position supported by the findings of the independent Seed Advisory report.

With affordability featuring as the key priority of customers, we have observed some focus on lowering transmission prices. There is credible evidence that their engagement with the CAP has influenced the Revenue Proposal to the benefit of consumers.

## 1.1 Key issues and themes of the proposal for consumers

ElectraNet’s engagement with their CAP Working Group (the **CAP**) was initially mostly at the lower (“inform” and “engage”) end of the IAP2 spectrum. Around two months before the Revenue Proposal was lodged, the engagement program shifted markedly to a more collaborative approach. We consider it to be a strength of the engagement process that ElectraNet could recognise its shortcomings and take action to address the concerns of consumer representatives before submitting its Revenue Proposal.

ElectraNet and the CAP agreed to focus on topics where there was capacity for consumer input to influence outcomes meaningfully. ElectraNet aimed for a proposal that would have a low-cost impact on consumers with no major augex projects.

ElectraNet has relied on a dollar value reduction from the preliminary proposal to account for the impact of the consumer challenge on the proposal. The CCP is concerned that the if the Preliminary Proposal is not prepared with a very high level of accuracy, then the perception of consumer impact may in fact be better understood as cost corrections. The moral hazard is that networks are

incentivised to artificially inflate preliminary proposals. Despite the base measures of these changes being in dollars, which does not preclude the chance of an excessively high initial estimate, our sense of the CAP workings suggest these reductions are largely genuine.

Introducing ElectraNet's proposal, the Interim Chief Executive states that *"As renewable energy uptake continues, South Australia's transmission network is playing an increasing role in managing two-way power flows and sharing power between regions to where and when it is needed. As renewable generation has grown, important system services provided by traditional generators have been lost, with the transmission network increasingly called upon to bridge the gap."* ElectraNet will play a key role in the changing energy landscape as the move to a low carbon economy gathers even greater momentum

Whilst ElectraNet discusses the ability for transmission investment to facilitate access to lower-priced renewable generation, the CCP sees benefit in looking beyond this trade-off between transmission investment and wholesale prices. In the face of the emerging upward pressure on many parts of the electricity bill, we consider that ElectraNet should continue to pursue efficiency and productivity. One approach would be for ElectraNet to set capital productivity improvement targets, particularly in the face of the challenges that will emerge over the next 10 years.

We are concerned by the increase in 'underlying' regulated costs and revenue. ElectraNet is proposing a regulated revenue of \$1,709M (\$2022-23), \$63M more than the expected expenditure in the current regulatory period. The predominant downward influences on the revenue are exogenous factors such as WACC and a change to taxation allowance. In contrast, increases in depreciation, driven by the recent growth in the Regulated Asset Base (RAB) and markedly higher operating costs more than cancel out the downward movements. Now, more than ever, we expect a sharp focus on underlying costs and efficiencies. We welcome ElectraNet's proposed 1.5% productivity improvement target for operating costs.

Regarding capital investment, recent investments by ElectraNet has put upward pressure on prices. The 0.8 per cent increase in transmission prices forecast by ElectraNet would see the annual electricity bill of a typical residential South Australian customer increase by approximately \$5 in 2024. Of concern are the contingent and ISP projects, which should they proceed, will put further pressure on transmission costs for years to come. We have a specific concern with the uncertainty of costs and timing due to the external factors of increasing specialised labour and materials costs and the ability to deliver these projects to schedule as required.

ElectraNet provides evidence in its proposal that there have been changes in the costs of capital projects and operational expenditure based on input from the CAP. Specifically, a reduction of 12% in capex and 3% in opex compared to the position set out in the Preliminary Revenue Proposal. We take the view that the "straw man" approach should be treated with a high degree of scepticism.

The CAP Working Group wanted the link between the identified need for technology projects and customer benefits to be clearly established and those benefits should be central to development of projects. That is, the value to customers must be clear.

## 2 Consumer engagement

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### 2.1 The challenges in assessing ElectraNet’s proposal

Notwithstanding the limits due to COVID-19 in moving to online meetings with ElectraNet and others, there were significant factors that limited our ability to undertake this role and provide this advice regarding the impact of the consumer engagement in ElectraNet’s 2023-28 regulated revenue proposal.

With the CCP only being appointed in the weeks before the proposal was lodged, our opportunity to observe the Consumer Advisory Panel, or CAP, in action was extremely limited, as was our ability to access CAP members to further explore the Panel’s operation. We were able to interview two CAP members to provide more background on the engagement itself prior to preparing this advice. This means that we are reporting based primarily on our review of the documents and discussions after decision making, rather than on observing the engagement process itself.

As ElectraNet is central to a significant new transmission initiative outside the regulatory reset process. This is Project EnergyConnect, a new interconnector linking the South Australian and New South Wales transmission networks. Project EnergyConnect is the largest capital program undertaken by ElectraNet and has been a major focus of the business over the current regulatory period. In the period prior to June 2021, this project and the ElectraNet “Network Vision” dominated the work of the CAP.

### 2.2 CCP review of ElectraNet’s consumer engagement

The CCP 25 sub-panel was appointed on 19 November 2021. The CCP observed the Consumer Advisory Panel (CAP) Working Group meeting on 2 December 2021 and the CAP meeting on 13 December 2021.

The CCP has accessed publicly available CAP meeting papers. The CCP has not assessed ElectraNet’s consumer engagement on matters outside of the Regulatory Reset process. Where, for example, ElectraNet’s CAP meeting addressed a range of different issues, we have only reviewed Regulatory Reset agenda items.

The CCP discussed ElectraNet’s consumer engagement with ElectraNet on 22 March 2022 and with two members of the CAP on 25 and 28 March 2022.

We continue to observe ElectraNet’s Regulatory Reset consumer engagement activities.

### 2.3 Key issues with ElectraNet’s consumer engagement

The CCP’s assessment of ElectraNet’s consumer engagement process leading up to the submission of the Revenue Proposal has identified the following observations.

- **Partnership with consumers**

The Better Resets Handbook challenges networks to work with consumers as “partners in forming proposals rather than simply being asked for feedback on a proposal”.<sup>1</sup>

ElectraNet’s engagement with the CAP Working Group was initially mostly at the lower (“inform” and “engage”) end of the IAP2 spectrum. ElectraNet and the CAP Working Group stakeholders agree that the 15 October 2021 meeting was the catalyst to shift the engagement to a greater degree of co-

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<sup>1</sup> Better Resets Handbook, p 13.

design and more mature engagement. This shift occurred relatively late in the engagement program. ElectraNet and the CAP Working Group had approximately 2 months collaborating before the Draft Proposal was lodged with the AER.

The Seed Advisory report states:

*“The unknown is whether a better functioning Working Group focussing on the regulatory proposal for longer, rather than engaging intensively near the end of the time available would have identified further topics for targeting and/or potential cost savings”<sup>2</sup>*

The CCP shares this concern. We consider it important that a high level of scrutiny be applied to the remainder of the regulatory review processes.

The CCP does, however, consider it to be a strength of the engagement process that ElectraNet could recognise its failure and take action to address the concerns of consumer representatives before submitting its Draft Proposal.

- **Consumer representation**

ElectraNet’s CAP includes a range of “peak representative organisations spanning general customers, the disadvantaged, business interests, local government, industry, small business and the mining sector”.<sup>3</sup> The CAP’s key role in the regulatory reset has been the oversight of the engagement approach. A four-person CAP Working Group, a sub-set of the CAP, was formed in July 2021 “for the purpose of more detailed engagement ... through a series of intensive workshops”.<sup>4</sup> Two of the CAP Working Group members, Mark Henley and David Headberry, are very experienced in representing consumer interests in transmission regulation, while Mark Sutton and Vikram Kenjle are relatively new to the process. Sadly, David Headberry died in November 2021.

CCP discussions with ElectraNet and consumer representatives confirm that the CAP Working Group has been the primary avenue of challenge from consumer representatives. ElectraNet, on the advice of the CAP, elected not to undertake any direct engagement with small consumers. The Stakeholder Forum held on 12 August 2021 appears to have mainly served as an avenue to inform large users, with just 2 questions being recorded in the Meeting Notes.<sup>5</sup> Two written submissions were received in response to the Preliminary Proposal.

The National Electricity Rules require the AER to have regard to the extent to which the TNSP’s operational and capital expenditure addresses the concerns of electricity consumers as identified by the TNSP in the course of its engagement with electricity consumers.<sup>6</sup>

ElectraNet’s consumer engagement program relied heavily on the four members of the CAP Working Group to provide effective challenge to the network. This was a heavy burden. The CCP considers that the CAP Working Group members would have been better able to provide the necessary challenge with more time, more support for the newer and less experienced consumer representatives and the

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<sup>2</sup> Seed Advisory, Consumer Engagement Report, Report for ElectraNet, 28 February 2022, p 27.

<sup>3</sup> ElectraNet, Customer Engagement Outcomes Report, Revenue Proposal 2023-24 to 2027-28, 31 January 2022, p 9.

<sup>4</sup> ElectraNet, Customer Engagement Outcomes Report, Revenue Proposal 2023-24 to 2027-28, 31 January 2022, p 14.

<sup>5</sup> Preliminary Revenue Proposal Stakeholder Forum, 12 August 2021, Meeting notes accessed at <https://www.electranet.com.au/wp-content/uploads/2021/08/Stakeholder-Webinar-QA-12-Aug-2021.pdf> on 2/5/2022.

<sup>6</sup> National Electricity Rules, Rules cl. 6A.6.7(c) and cl. 6A.6.6(c).

ability to spend the independent budget that had been allocated to them. Although the CAP also had the ability to access independent expertise and advice, no independent advice was ever sought.<sup>7</sup> Relying intensively on such a small group of people also brought key person risks into the engagement process.

More broadly, we query whether the intent of the National Electricity Rules is being met with an engagement program that includes a heavy reliance on a very small number of consumer representatives. The CCP has not been able to form a conclusive view on this point due to our limited opportunity to observe the CAP and CAP Working Group processes.

- **Outcomes of CAP Working Group engagement**

ElectraNet's Draft proposal reports specific detail about the concerns raised by the CAP Working Group and how ElectraNet has addressed these concerns.<sup>8</sup> The Better Resets Handbook explains that clearly evidenced impact is about how a proposal represents and is shown to represent consumer views.<sup>9</sup>

The CCP observes that in several instances the network has relied on a dollar value reduction from the preliminary proposal to account for the impact of the consumer challenge on the proposal. The CCP is cautious about using such figures. We are concerned that if the preliminary proposal is not prepared with a very high level of accuracy, then the perception of consumer impact may in fact be better understood as cost corrections. The moral hazard is that networks are incentivised to artificially inflate preliminary proposals.

## 2.4 [ElectraNet's approach to consumer engagement](#)

- **Transparency and accountability**

The CCP welcomes ElectraNet's inclusion in its Draft Proposal of the Seed Advisory report, co-written by Seed Advisory and Mark Henley. The Seed Advisory Report adds the direct voice of stakeholders, in particular the CAP Working Group members, to the Draft Proposal. The CCP considers that the report reflects ElectraNet's good engagement culture.

## 3 [The long-term interests of consumers](#)

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### 3.1 [Key elements of the proposal](#)

ElectraNet submitted its regulatory proposal for the period 2023-28 to the Australian Energy Regulator (AER) on 31 January 2022, in preparation for the AER to publish a draft decision in September 2022 and a final regulatory determination by 30 April 2023. The proposal totals about 50 documents.

In our assessment of ElectraNet's Revenue Proposal, the CCP has made the following observations:

- **Rising revenue and transmission prices**

For their regulated activities, ElectraNet is forecasting a 3.8% rise in required revenue from the current period forecast, due largely to the influence of recent capital expenditure on synchronous condensers

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<sup>7</sup> Seed Advisory, Consumer Engagement Report, Report for ElectraNet, 28 February 2022, p28.

<sup>8</sup> See for example ElectraNet Customer Engagement Outcomes Report Revenue Proposal 2023-24 to 2027-28, 31 January 2022, p17-20

<sup>9</sup> Better Resets Handbook, p16



(required by AEMO for grid stability) and Project EnergyConnect. This initial rise in transmission prices is followed by a fall in required revenue by 1.7% to \$342 million per year from 2023.<sup>10</sup>

As has been seen in several recent revenue proposals, the predominant downward influences on the price are exogenous factors such as the fall in the Weighted Average Cost of Capital (**WACC**) return from 5.43% to 4.29% based on then current market data and parameters and a fall in corporate income tax using the AER's revised approach to the treatment of regulatory income tax. The WACC is dependent on the risk-free rate of return, which is currently rising.<sup>11</sup>

A positive message in the proposal is the relatively small increase in average prices to consumers.

Although ElectraNet's revenue is expected to be flat, the business estimates that real transmission prices will increase by 0.8 per cent in 2024 due to reduced energy throughput and remain relatively steady thereafter. ElectraNet use the AEMO's forecast of the amount of electricity that will pass through its network and AEMO has forecast that this energy throughput will decline. In South Australia, transmission prices are approximately 10% of a retail electricity bill. The 0.8 per cent increase in transmission prices forecast by ElectraNet would see the annual electricity bill of a typical residential South Australian customer increase by approximately \$5 in 2024.

- **Upward pressure on transmission prices due to potential further investment and WACC risk**

The Transmission Annual Planning Report 2021 notes additional potential network investments that flow from the 2020 Integrated System Plan (ISP) to strengthen the network and provide for connection to new Renewable Energy Zones. Whilst these projects are outside the scope of the current regulatory reset, it is important for customers to get a view of the overall impact of possible transmission development on prices.

Of concern is the significant value of contingent projects listed in the proposal, with a potential cost of between \$180 and \$360 million dollars. Contingent projects and ISP expenditure are an outcome of a very dynamic energy landscape. This has rapidly changing needs to meet the growth of renewable generation and large storage, the development of new 'green' loads and the strong influence of government policies. The matter of contingent projects was a feature of the CAP engagement.

ElectraNet carefully explains that Contingent and ISP projects will result in an increase in the Regulated Asset Base and will increase transmission costs, however there is no specific quantitative or risk-based analysis in the Proposal that could indicate the possible impact of these projects on transmission prices to consumers. We strongly suggest that ElectraNet undertake this work and present it to their CAP. We see ElectraNet producing information that reflects the impact of these potential investments on prices and RAB as critical in ensuring customers have the best information available regarding possible future bill impacts.

- **Capital Investment and the Regulated Asset Base**

The forecast regulated capital investment for 2023-28 is \$734 million, 47% lower than the estimate investment in the current regulatory period.<sup>12</sup> The underlying capex is \$683 million which is a reduction of 18%, but which excludes ISP projects. This reduction is due primarily to the reduction in network augmentation investment, although there is also a considerable reduction in replacement and refurbishment expenditure.

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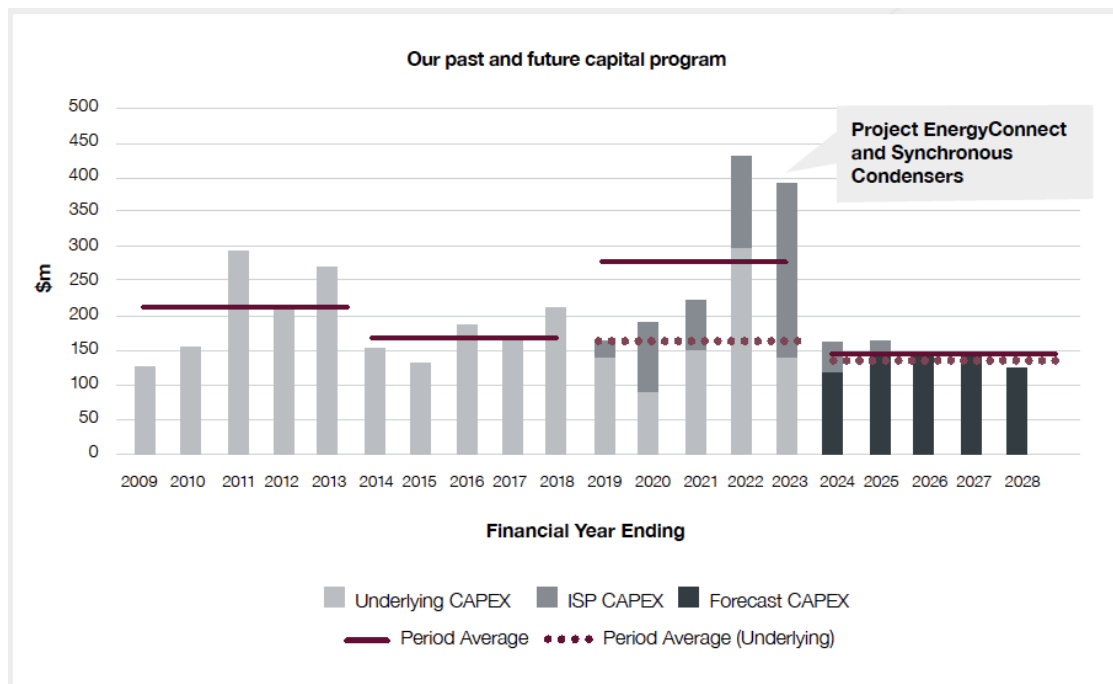
<sup>10</sup> Expressed in \$Real June 2023.

<sup>11</sup> For example, <https://www.rba.gov.au/speeches/2022/sp-gov-2022-05-03.html> accessed 11 May 2022.

<sup>12</sup> ElectraNet Revenue Proposal Overview 2024 –2028, p 29.

As noted above, our concern is with the impact of the un-modelled contingent and ISP projects on the overall consumer electricity bill for years to come.

Figure 1 below shows ElectraNet’s forecast capex in a 20-year context, where ElectraNet expects capex in 2024-2028 to be lower in real terms than it has been in the last fifteen years. Note the impact of Project EnergyConnect and the synchronous condensers which have increased capex in the current period. The underlying capital expenditure forecast is less in 2024 to 2028 than actual and forecast spend in the current period, or in either of the previous two.

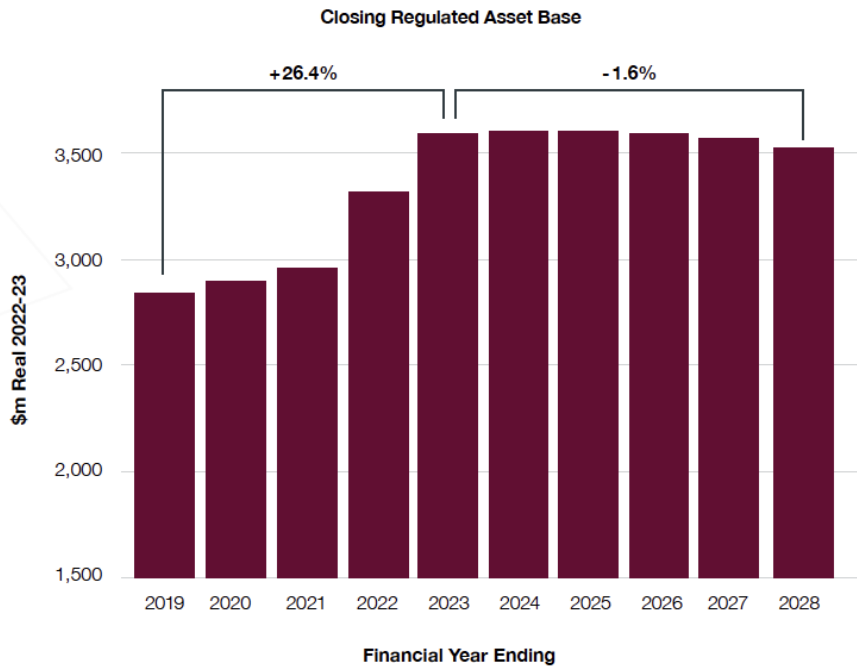


**Figure 1: ElectraNet forecast and historical capex**

Source: ElectraNet Revenue Proposal Overview 2024–2028 Page 27

ElectraNet’s Regulated Asset Base (RAB) has grown significantly in the current regulatory period, due in large part to the major investments driven by AEMO’s ISP. These investments were designed to put downward pressure on total prices. As **Figure 2** shows, ElectraNet’s RAB is now declining in real terms from 2024 because of the business’ reduced capex forecast.

Other than the exclusion of the contingent projects, we have no significant comments on ElectraNet’s proposed capital works program. We note that ElectraNet claims a top-down and bottom-up review of the investment program, as well as influence from the CAP in the scope of several projects.



**Figure 2: ElectraNet Regulated Asset Base trend.**

Source: ElectraNet Revenue Proposal Overview 2024–2028 Page 46

- **Capital investment plans show a high level of uncertainty**

The energy market continues to transition at an unprecedented rate, with changes occurring right across the energy supply chain. Changes in Government policies, the impact of the global pandemic on labour and material availability and prices, and the expected boom in transmission and renewable generation infrastructure projects suggest major challenges lie ahead for the supply of specialised materials and labour.

In this period of rapid change, material changes in conditions and costs can occur over the period between the early stages of engagement and the final decision, then through the actual five-year regulatory period. This uncertainty creates challenges for the utilities, consumers and the AER.

ElectraNet has chosen to exclude three significant projects from the base capital forecasts and asset base value projections on the basis that they are contingent on the outcome of Regulatory Investment tests. These projects can potentially add another \$360M to the capital programme, increasing the asset base by more than 50%. In addition, further contingent projects may be identified by AEMO.

We appreciate that ElectraNet has been transparent in their Revenue Proposal by identifying these projects. On the other hand, ElectraNet has not clearly presented other influential factors such as the likely cost escalations and factor in a forecast limited resource availability.

While the allocation of projects as contingent is not unusual practice, given that the Revenue Proposal suggests that many of these projects may meet their trigger criteria, our concern these works have the potential to significantly increase prices to consumers in both the short and longer term, beyond those presented in the Revenue Proposal.

We note that these investments have featured in the discussion of the CAP, and that the CAP has considered the timing and risks to some extent.

We are expecting that ElectraNet will be able to incorporate the status of the project triggers and escalated costs more confidently at the time of their Revised Proposal. We encourage ElectraNet to

continue to use their CAP to update the confidence of the proposed investments to assist reasonable assessment by consumers as better information unfolds.

- **Operating costs**

ElectraNet is proposing an operating cost of \$626.5M (\$2022-23), a significant increase of 17% from than the estimated costs in the current period. Approximately one-third of the increase is the increase output growth driven by the increase in circuit length as a result of recent major capital projects.

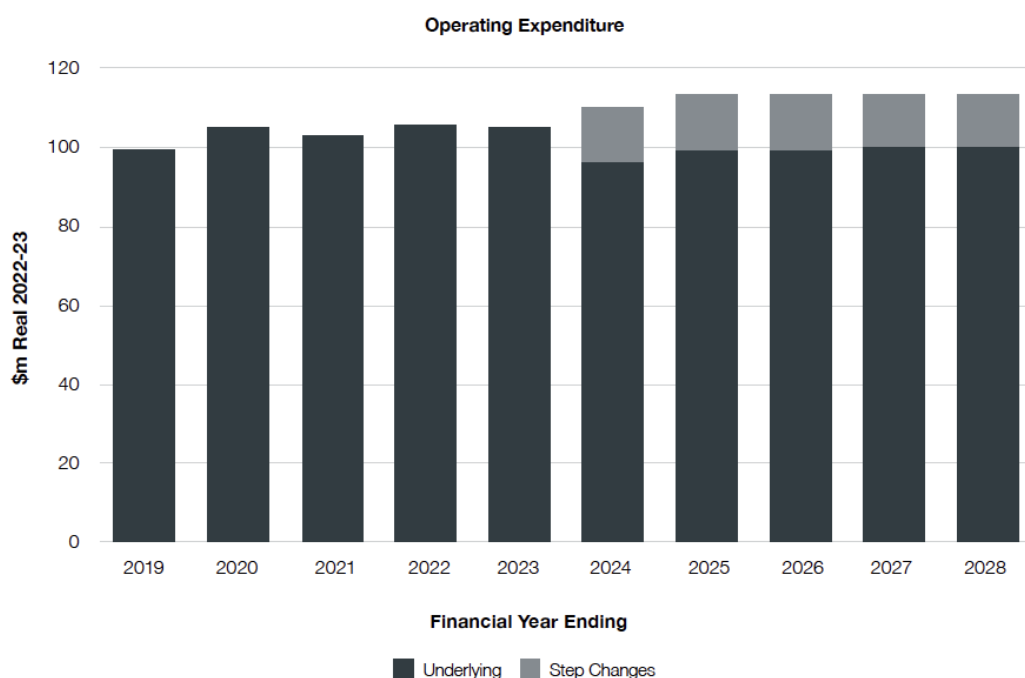
There is also a risk of additional operating costs should AEMO require further network support; nominated as a cost pass-through event. As with many system services requirements, the risk and quantum of these requirements are opaque to the reset process.

The utility identifies four specific external factors driving increased operating costs:

- (a) insurance costs,
- (b) critical infrastructure requirements regarding cyber and physical security,
- (c) a need for increased specialist resources in areas such as network planning, and
- (d) increased information opex associated with capex reduction.

ElectraNet treats these as step increases in operating costs from otherwise stable levels. The business also argues that its capital expenditure in the current regulatory period has grown South Australia’s electricity transmission network by about 12 per cent. This growth drives up opex, but this pressure is offset by the outcomes of the capital investment (for example, removal of the need to provide generation support to Port Lincoln).

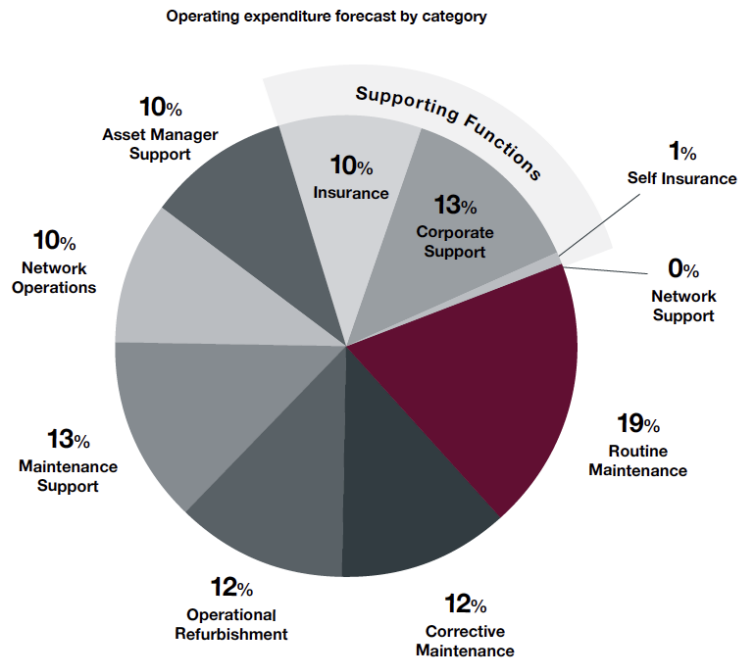
As set out in Figure 3 below, ElectraNet’s total operating expenditure is forecast to be approximately \$116 million in 2025 and to remain stable thereafter.



**Figure 3: ElectraNet operating expenditure**

Source: ElectraNet Revenue Proposal Overview 2024–2028 Page 39

The breakdown of operating expenditure forecast by category is set out in Figure 4.



**Figure 4: ElectraNet breakdown of operating expenditure**

Source: ElectraNet Revenue Proposal Overview 2024–2028 Page 40

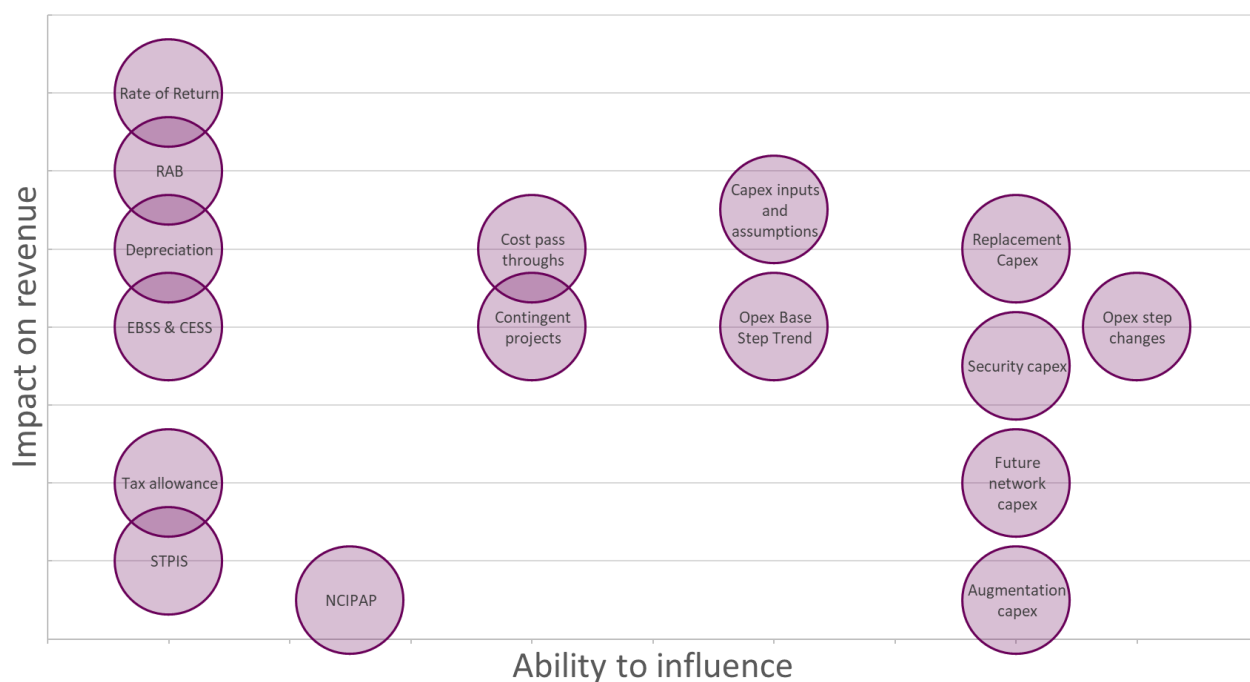
### 3.2 Considering the proposal through the consumers’ lens

The framing of the ElectraNet proposal was the Network Vision statement that was created in 2020 and early 2021. This formed the basis of the engagement although it is subject to the caveat set out in the Seed Advisory report:<sup>13</sup>

*The relationship between the Network Vision engagement and the regulatory proposal was probably stronger and clearer for ElectraNet than the CAP Working Group.*

ElectraNet and the CAP agreed to focus on topics where there was capacity for consumer input to influence outcomes meaningfully. ElectraNet aimed for a proposal that would have a low-cost impact on consumers with no major augex projects. In that context, ElectraNet prepared a summary of topics that could have been considered plotted against revenue impacts and ability to influence. This is set out in Figure 5.

<sup>13</sup> Seed Advisory, Consumer Engagement Report, Report for ElectraNet, 28 February 2022, p 33.



**Figure 5: ElectraNet themes for engagement**

Source: ElectraNet Customer Engagement Outcomes Report Page 23

Our observation of the engagement and assessment ElectraNet’s regulatory proposal has highlighted several issues and themes that have significantly influenced the way the proposal was considered by their CAP and presented information to consumers. Some of these have been highlighted in the Seed Advisory Report<sup>14</sup> and the ElectraNet Customer Engagement Outcomes Report. The key topics covered by the CAP Working Group identified by ElectraNet were:

- Lowest Possible Costs
- Customer Centric Approach
- Collaboration between ElectraNet, SA Power Networks and AEMO
- Tower Anti-Climb
- Northern REZ Strategic Land Acquisition
- Power Quality Management Project
- Cyber Security
- Substation Security

The Revenue Proposal references many of these issues and the most notable aspects of the proposal are discussed below.

**a) Lowest Possible Costs**

The ElectraNet Customer Engagement Outcomes Report identified the views of the CAP on costs:<sup>15</sup>

<sup>14</sup> Seed Advisory, Consumer Engagement Report, Report for ElectraNet.

<sup>15</sup> ElectraNet Revenue Proposal Overview 2024–2028, p 24.

*ElectraNet should be doing everything possible to keep its costs as low as possible – ElectraNet’s high comparative operating costs compared with other Electricity Transmission Network Service Providers (TNSPs) based on AER benchmarking was highlighted*

ElectraNet provides evidence in its proposal that there have been changes in the costs of capital projects and operational expenditure based on input from the CAP. Specifically, a reduction of 12% in capex and 3% in opex compared to the position set out in the Preliminary Revenue Proposal. We take the view that the “straw man” approach should be treated with a reasonable degree of scepticism. There is a risk that, in a compressed engagement period, achieving some cost savings might miss others. This risk is highlighted in 2.3 above.

The capex proposed in the Revenue Proposal is \$98M lower than in ElectraNet’s Preliminary Revenue Proposal. This was split into project scope reductions (\$69 million), project cost reductions (\$22 million) and projects being cancelled or deferred (\$51 million). This meant that ElectraNet could say:<sup>16</sup>

*Overall, the Working Group indicated it was satisfied that our risk-based systems and processes for capital planning are robust, and that reducing capital expenditure has been a focus of our Revenue Proposal.*

ElectraNet used one of the project cost reductions to provide evidence of its customer centric approach.

The CAP Working Group wanted the link between the identified need for technology projects and customer benefits to be clearly established and those benefits should be central to development of projects. That is, the value to customers must be clear.

It seems to us that this is a reasonable approach to ensuring that project decisions are customer centric.

The effect of this was the change of scope and scale of the technology program (\$8 million) and the tower anti-climb (\$15 million). The tower anti-climb project also highlighted the value of specific expertise in providing a consumer lens. The inclusion of Lifeline, on the initiative of the CAP Working Group, provided the basis for prioritisation of towers under the project.

The approach was also applied in respect of the Northern REZ strategic land acquisition. However, in this case the CAP Working Group was satisfied that the acquisition was cost-effective. That is, a consistent approach means that well designed projects can proceed as proposed.

ElectraNet also provided evidence that the CAP Working Group proposed solutions that allowed for deferral of projects until an identified trigger occurs. This included the power quality management project, which is now a Contingent Project. Rather than making an investment as part of the Revenue Proposal, ElectraNet will install measuring devices to better identify the issues to be addressed and develop a more targeted and staged solution. Another example is on cyber security where, based on CAP Working Group engagement, ElectraNet will rely on a cost pass-through if cyber insurance becomes unavailable and we incur material costs as a result of a cyber incident.

This allowed the Seed Advisory Report to note:<sup>17</sup>

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<sup>16</sup> ElectraNet Customer Engagement Outcomes Report, p 17.

<sup>17</sup> Seed Advisory, Consumer Engagement Report, Report for ElectraNet, p 19.

*The view of the Working Group was that if consumers are satisfied that internal processes, particularly about expenditure proposals, are robust, rigorous and transparent, then outcomes will be well respected.*

#### **b) Collaboration between ElectraNet, SA Power Networks and AEMO**

ElectraNet identified the collaboration and coordination issue with other players in South Australia and at the Commonwealth level (in addition to the AER):<sup>18</sup>

*Customers expect close cooperation and collaboration between ElectraNet, SA Power Networks and AEMO to ensure efficient, coordinated solutions are developed in response to the challenges of South Australia's energy transition, and to avoid doubling up or overlapping solutions.*

However, the coordination proposed by ElectraNet did not include either the CAP or the CAP Working Group. One aspect of coordination is the coordination of the consumer centricity which is the heart of the engagement process.

#### **c) Maintain a focus on productivity, innovation and cost reductions**

There has been discussion from many quarters, including ElectraNet, suggesting further investment in transmission capability will facilitate the access of lower-priced energy from renewable sources. Whilst we do not wish to enter this discussion, there is a view that there are so many variables and moving parts in the constitution of the customer's energy bill, that each contributor to the cost stack should do all they can to drive efficiencies and cost awareness in their own operations.

Once the impact of further AEMO-driven requirements and the contingent projects are incorporated, the more likely outcome for consumers is a continued rise in the TUoS component of bills. The likely further rise in the value of the regulated asset base and the upward price influence of rising interest rates continues to be of significant concern to consumers.

ElectraNet would benefit from the setting of capital productivity improvement targets, particularly in the face of the challenges that will emerge over the next 10 years. Over this period, the energy market will undergo profound changes, and new costs will emerge because of these challenges.

### 3.3 Improving Engagement

ElectraNet critically examined the way that it engaged with the CAP and the CAP Working Group. The business identified several improvement opportunities and has implemented some of these in the period since the Revenue Proposal was lodged.

In our view, it is important that each of these improvements are implemented and that ElectraNet considers the Seed Advisory Report in considering further changes that could be made.

### 3.4 Themes to explore further

Whilst we agree with the areas of impact nominated in the ElectraNet Revenue Proposal, it would be useful if the revised proposal provided greater clarity and transparency on several key issues impacting energy consumers, including:

#### **d) Resilience - responding to the impacts of climate change**

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<sup>18</sup> ElectraNet Customer Engagement Outcomes Report, p 18.



Nationally, years of drought have left many rural Australian communities struggling emotionally and financially which has impacted on the capacity of some to be able to meet their electricity costs. The drought impacts were seriously exacerbated in many regions by the disastrous fires over the spring and summer of 2019-20. Energy businesses across Australia, including transmission companies, must demonstrate a multi-faceted commitment address these emerging and long-term impacts on electricity supply and communities generally.

From a commercial viewpoint, this is to maintain a strong downward pressure on prices to support impacted households, producers and businesses. Technically, effective and efficient ways of identifying, managing and responding to the environmental risk to electricity assets are needed.

**e) Electrification – Renewables and towards a low-carbon future**

The growth in renewable generation and energy storage – at the utility scale, distribution level and customer owned - is now the new normal in the energy industry. Whilst the majority of ElectraNet’s activities are driven by legislative and national agendas, consumers expect transmission companies to continue to demonstrate a commitment to lowest cost solutions and a respect for a low-carbon future in all their operations.

**f) Digitalisation – a focus on better asset management and greater utilisation of assets through information and analytics**

As digital tools continue to develop in the electricity industry, it is expected that transmission companies will prudently invest in monitoring, control and analytic capability to optimise the utilisation of existing assets through more dynamic decision making, customer information and innovative approaches, as a preference to new construction.

**g) Maintaining a case for restraint**

As we emerge into a post-COVID19 environment, we recognise the significant economic challenges that will be faced by many parts of our community. The long- term benefit of electricity consumers lies not in the provision of the best levels of customer service, or the most elegant response to future network needs, but in the spirit of the proposals to have affordability and balance as the uppermost priority.

We are also highly aware of the impact of a growing asset base will have on prices as the economy recovers and interest rates, with their influence on the allowable return on asset, will have on prices over the long term, as discussed below.

## **4 Response to questions from the issues paper**

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*Q1. Do the key themes from ElectraNet’s engagement resonate with your own preferences? Are there additional issues you would like to see influence ElectraNet’s proposal and our assessment of the proposal?*

The headline outcomes for customers were set out in section 3.2 above.

Overall, we agree that the key themes of the engagement concur with the expectations and requirements of consumers of a transmission entity. The limitation on the depth of engagement was the delay in addressing the reset and the late pivot in the engagement process set out above and identified in the Seed Advisory Report.

There is some visibility of ElectraNet’s perspective of these drivers as influencing the energy future, and the themes are consistent with ElectraNet’s ‘business as usual’ objectives. It would be preferable that ElectraNet take a longer-term view of these themes beyond the 2023-28 regulatory period, however we appreciate that the many external influences and uncertainty that prevail make such longer-term analysis difficult. In addition, the five-year reset process tends to set a natural time horizon. Having said this, other Network Service Providers attempt to use AEMO data to look further into the future.

- **Other issues to explore**

Please refer to section 3.4 above.

*Q2. Do you think ElectraNet has engaged meaningfully with consumers on all key elements of its 2023–28 proposal? Are there any key elements that require further engagement?*

ElectraNet’s process limited time for meaningful engagement. This created pressure to ensure that the CAP Working Group’s limited resources were used efficiently. There is some evidence that the process looked for high impact engagement opportunities but also some evidence that more time could have been usefully spent on contentious topics.

As set out above, ElectraNet’s engagement with the CAP Working Group was initially mostly at the lower (“inform” and “engage”) end of the IAP2 spectrum. ElectraNet and the CAP Working Group stakeholders agree that the 15 October 2021 meeting was the catalyst to shift the engagement to a greater degree of co-design and more mature engagement. This shift occurred relatively late in the engagement program. ElectraNet and the CAP Working Group had approximately 2 months collaborating before the Draft Proposal was lodged with the AER.

Having said this, ElectraNet has identified steps that it will take to improve engagement in the next stages of the reset process. It is essential that all these steps are taken. The outcomes of adopting these steps is likely to be a more meaningful engagement.

- **A focussed discussion to explore all options to address affordability**

We feel strongly about this need, especially given the potential of increasing network costs over time because of significant historic capital investment and rising allowable returns on investment.

As noted above in section 4, we believe that ElectraNet could take a stronger position on how it is driving productivity and pursuing value for consumers in across its investment expenditure and operating cost portfolio.

*Q3. To what extent do you consider you were able to influence the topics engaged on by ElectraNet? Please give examples.*

The CCP was not able to observe this aspect of the engagement process.

*Q4. Do you have views on ElectraNet’s proposed depreciation approach, as set out in its 2023–28 proposal?*

The issue of RAB growth and depreciation remain of significant interest to consumers given the significant impact it has on energy prices (TUoS component) in the short and long term.

The ElectraNet RAB is forecast to increase significantly, from \$2.8 billion opening in nominal terms in 2019, to a forecast \$3.6 billion by the end of 2027. This growth does not consider the impact of yet to be approved ISP projects and contingent projects.

As ElectraNet is essentially adopting the same asset lives as those approved in the current reset period and the depreciation is calculated within the AER's post-tax revenue model, we have no issues with the methodology applied.

ElectraNet has written down the residual value of assets scheduled to be replaced in the coming regulatory period, consistent with accepted practice. We note that the depreciation forecast is approximately 11% more than actual and forecast depreciation in the current regulatory period (\$341m compared to \$307m). This is driven by growth in the asset base as a result of the large investments being completed in the current period.

The depreciation level is reflected in a decline of expected RAB in the last years of the forthcoming regulatory period.

*Q5. Do you consider ElectraNet's capex proposal addresses the concerns of electricity consumers as identified during its engagement on the proposal?*

In our view, the capex proposal has reflected the engagement with the CAP Working Group. As we have set out, we are concerned that the impact of the engagement is described in terms of dollar savings compared with an ElectraNet generated "straw man" in the form of the Preliminary Revenue Proposal.

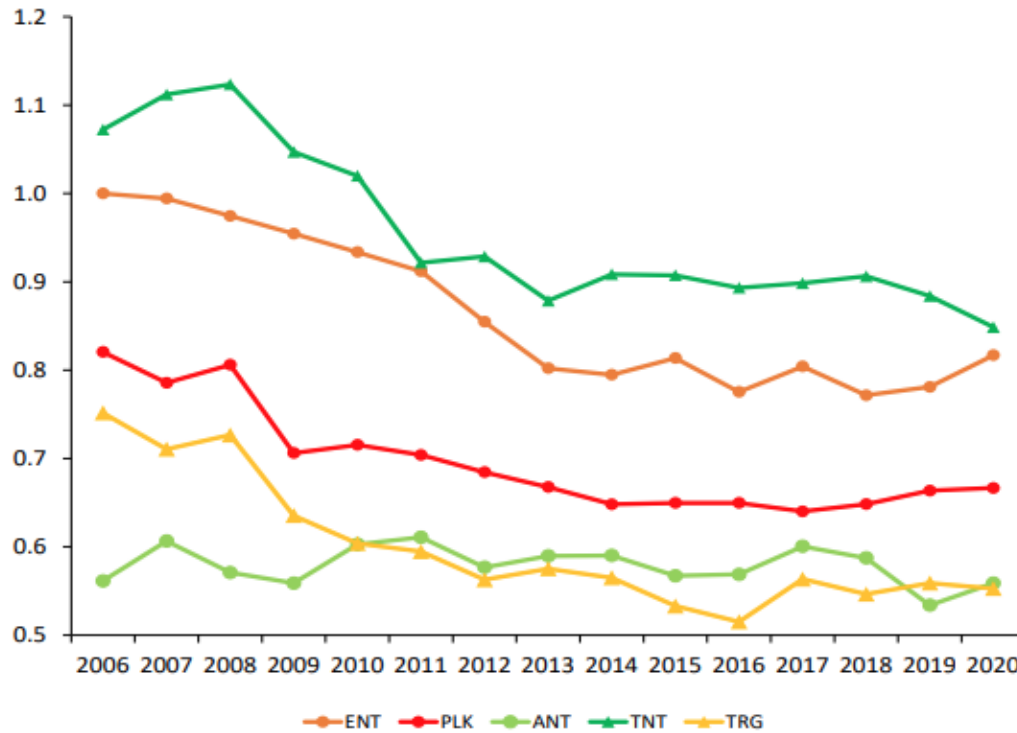
The CAP Working Group did "shift the dial" in respect of capex. However, it is not clear whether the dial's starting point was set to facilitate such a shift.

- **Capex productivity**

We are aware of the challenges ElectraNet will face in the next decade balancing investment and utilisation with rapidly developing demands on transmission networks. We strongly encourage ElectraNet to develop and communicate, in conjunction with its stakeholders, a discussion on opportunities to address the input cost risks and project efficiency.

The AER Annual benchmarking Report 2021 notes ElectraNet's improving capital efficiency index (Figure 6). We see the role of a clear productivity and efficiency program as being integral to increasing the level of consumer trust and support of future programs of work.

**Figure 10 Capital MPFP index, 2006–20**



**Figure 6: Capital multifactor productivity benchmarking**

Source: AER Annual Benchmarking Report, November 2021, Figure 10

Q6. *Do you consider ElectraNet’s approach to forecasting replacement capex is appropriate and likely to produce a forecast of efficient replacement capex?*

Replacement capex was the subject of a “deep dive” with the CAP Working Group in July 2021. However, the ElectraNet Customer Engagement Outcomes Report does not mention replacement capex or the equivalent “replex”. Similarly, the Seed Advisory Report identifies replacement expenditure as a “material consumer issue” but does not address engagement on this point. As a result, our response is that the CCP has not observed forecasting of replacement capex in the engagement process.

Q7. *Do you consider ElectraNet’s economic assessment framework and project documentation provide appropriate justification for its proposed capex projects and programs?*

Our review of the engagement of the CAP Working Group by ElectraNet suggests that the CAP Working Group was able to test the logic of its proposed capex projects and programs. However, we present no opinion on the economic assessment framework and project documentation.

Q8. *Do you consider ElectraNet’s total forecast capex reasonably reflects the efficient costs of a prudent operator?*

We present no opinion on this issue.

*Q9. Do you consider ElectraNet's proposed contingent projects should be included as contingent projects for the 2023–28 period? Are the proposed project triggers appropriate?*

The CAP working Group considered contingent projects and the feedback in the Seed Advisory Report was that identified the need for CAP involvement in ongoing monitoring and updates on contingent projects. As noted above, engagement with the CAP Working Group led to the Power Quality Management Project being transferred from the capex budget to a contingent project. The CAP Working Group meeting of 15 October 2021 included discussion of the proposed contingent projects. After this meeting, the CAP Working Group received a summary of the contingent projects and their associated triggers.

As set out above, we are concerned with the range of costs associated with each of the contingent projects. That is, the extent to which they are uncertain. Please refer to our comments in Question 5 and in section 3 of this advice.

We do not express a view on whether the triggers are appropriate.

*Q10. Do you consider ElectraNet's opex proposal addresses the concerns of electricity consumers as identified in the course of its engagement on the proposal?*

In section 2 we have discussed the overall observations of ElectraNet's engagement. There is evidence of changes in the operating costs set out in the Preliminary Revenue Proposal because of the engagement with the CAP Working Group. The same caveats apply as in our response to Q5.

We are concerned that labour and materials cost escalations are subject to a high degree of sensitivity to emerging market conditions and look forward to updates on the assumptions during the AER's assessment of the proposal.

Again, on the condition of further analysis by the AER, we present no issue with the proposed step changes.

*Q11. Do you consider ElectraNet's forecast opex for the 2023–28 period reasonably reflects the efficient costs of a prudent operator?*

We present no opinion on this issue.

*Q12. Do you consider it appropriate to recover the costs of the proposed nominated cost pass through events—and in particular those covered by the two new events proposed by ElectraNet—through the pass-through mechanism?*

The CAP Working Group considered the pass-through events. There is evidence that the cyber pass through was driven by engagement with the CAP Working Group. It would be reasonable for ElectraNet to confirm with the CAP Working Group that it is still of this view.

Despite the frustration that many projects that have the potential of significantly impacting transmission prices for a long time are shielded from customer scrutiny, we acknowledge the nominated pass-through events as being largely out of ElectraNet's control and therefore present no objection to them.

*Q20. Do you consider ElectraNet's proposed changes to its pricing methodology for the 2023–28 period are appropriate and give effect to the pricing principles for prescribed transmission services?*

We have no comment on the proposed changes to ElectraNet's pricing methodology.

*Q21. Do you have any concerns on the requirement for customers to provide notification of annual demand adjustments by 1 February each year?*

We are not aware of evidence that this matter was considered by the CAP or the CAP Working Group. If we are correct, then this is an issue which should reasonably be considered by the CAP Working Group as a matter of urgency.

From a consumer perspective, there is a key issue. This is the question as to whether ElectraNet will use such demand forecasts to adjust its tariffs in a way that can be passed through by DNSPs and retailers to consumers. If this is the case, then there is a major concern that retail bills will vary significantly based on forecast, and not actual, demand. There is a risk that changes permitted by the AER for DNSPs to introduce export tariffs for solar PV, will lead to consumers engaging in the behaviour that is signalled by such tariff but having increases in the transmission component of their bill because of their changed demand.

## Appendix 1 – Acronyms and abbreviations

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<b><u>Acronym/Abbreviation</u></b>	<b><u>Meaning</u></b>
\$ nominal	These are nominal dollars of the day
real \$2022	These are dollar terms as at 30 June 2022 unless noted otherwise
Regulatory control period	the period commencing 1 July 2023 and ending 30 Jun 2028
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ARR	Annual Revenue Requirement
Augex	Augmentation expenditure
CAM	Cost allocation method
capex	Capital expenditure
CBD	Central business district
CCP	Consumer Challenge Panel
CESS	Capital efficiency sharing scheme
CPI	Consumer Price Index
DER	Distributed energy resources
TNSP	Transmission Network Service Provider
DM / DR	Demand Management / Demand Response
EBSS	Efficiency benefits sharing scheme
F&A	Framework and Approach
GWh	gigawatt hours
HV	High voltage
ICT	Information and Communication Technologies
MW	megawatt
NEL	National Electricity Law
NEO	National Electricity Objective
NER	National Electricity Rules (or Rules)
Next regulatory period	the period commencing 1 July 2023 and ending 30 Jun 2028
Opex	Operating and Maintenance Expenditure
PTRM	Post-tax revenue model
PV	Photovoltaic (Solar PV)

RAB	Regulatory Asset Base
Revenue Proposal	regulatory proposal submitted under clause 6.8 of the NER
Repex	Replacement capital expenditure
Revised Revenue Proposal	revised proposal submitted under clause 6.10.3 of the NER
RFM	Roll Forward Model
RIN	Regulatory Information Notice
TUOS	Transmission Use of System
WACC	Weighted Average Cost of Capital (also known as Rate of Return)