Summary of Key Issues Arising from AER Draft Decision on ElectraNet Revenue Proposal – 6 October 2022

Matter addressed in Revenue Proposal	Draft Decision Outcome	Outstanding Issues	What we heard on the key customer issues for the CAP and the role it should play	What other information does the CAP need?
1. & 2. Rule Changes ElectraNet proposed a step change of $0.8m pa ($3.9m total) relating to new obligations under the Rules that are not reflected in its historic costs. These will require additional specialist staff and systems for: • network planning • managing an increasingly complex network. ElectraNet also proposed a cost pass through event to cater for the cost of preparing new Renewable Energy Zone (REZ) Design Reports when required by AEMO in its Integrated System Plan (ISP).	The AER has not accepted this step change. It was not satisfied with its prudency or efficiency. It found that ElectraNet had not demonstrated that the costs are material or exceed general output growth. *Refer AER Draft Decision: Attachment 6, Section 6.4.3.5* The AER did not accept the cost pass through event for REZ Design Reports as it was not subject to the 1% materiality threshold required under the Rules. *Refer AER Draft Decision: Attachment 13, Section 13.4.3*	The resource pressures related to externally driven capability uplift requirements have increased further. AEMO's ISP issued in June 2022 identifies a significant capability uplift to manage a power system operating at 100% instantaneous renewable output by 2025. AEMO has developed a NEM Engineering Framework and Strategic Roadmap for this uplift. The 2022 ISP also requires ElectraNet to undertake preliminary works on two REZs, increasing the likelihood of REZ Design Reports being required in future ISPs. The likely cost impact is estimated at $1.2-$1.8m over the coming period	The CAP may be interested to engage in detail on how these issues can and should be best addressed.	

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6. Inertia Services This matter has arisen since the Revenue Proposal. On 17 February 2022 ElectraNet submitted a cost pass through application to the AER seeking to recover the costs of inertia services in 2022-23 of $4.1m. These services meet an inertia shortfall declared by AEMO and help stabilise the power system in the event South Australia is 'islanded' from the grid. ElectraNet is providing 200MWs of services in 2022-23 under contract from fast acting plant such as grid scale batteries. Costs are in two parts: • $2m pa fixed cost • $1.7m per hour when islanded A further gap of 360MWs remains to be addressed in 2023-24 and 2024-25.	In June 2022, the AER decided it was unable to approve ElectraNet's pass through application due to its timing after the initial event. However, it found that ElectraNet's procurement and contracting process is likely to have resulted in efficient costs. It also confirmed ElectraNet will be able to recover its efficient costs under the network support pass through arrangements, which allow such costs to be recovered in arrears.	Tendering for the 2023-24 and 2024-25 services is currently underway. After this time the Project EnergyConnect interconnector to NSW will remove the need for these services by reducing the risk of 'islanding'. Options for recovering the costs include: • Seek a network support allowance for the expected annual costs, with later 'true-up' for actual costs; • Rely on network support pass through after the event, with funding upfront by ElectraNet and passed on to customers two years later (adjusted for time value of money). Hybrid options are also possible. Under any option, customers will only pay the actual costs incurred under the contract.	The CAP appeared interested to engage with ElectraNet to explore the options for recovering these costs, and consider whether it is in customer's interests for prices to reflect: • The expected cost of providing these services at the time, with small true-up in arrears; • Recovery of full costs in arrears; or Hybrid approach	

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8. Price Impact The Revenue Proposal highlights a number of risks for customers. This includes the potential for increases in interest rates and changes in financial market conditions to increase the costs we incur in financing our business and increase prices for customers. Another key risk is underinvestment in the network, which creates risks for supply reliability and security and can increase investment needs in the future.	Total revenue has increased by approximately 15% in the Draft Decision, driven primarily by higher interest rates and inflation. Updating these movements is a standard part of the determination process. The Draft Decision results in an average real increase in transmission charges of around 9.1% in 2027-28 compared with current levels and a nominal increase in the average annual electricity bill for a residential customer of $54 over the same period.	The AER will be updating its forecasts of interest rates and inflation at the time of the Final Decision in April 2023. The possibility of further movement in inflation and interest rates (up or down) remains. Once the capex allowance is set, either now or subsequently, ElectraNet will need to prioritise new capex needs within the set allowance. This includes new expenditure requirements that have already arisen since the capex forecast included in ElectraNet's Revenue Proposal was finalised in late 2021. An example is the need to replace certain current transformers that have recently been identified as high risk at a cost of about $20-30m. ElectraNet will also need to accommodate other priorities that arise in the future. Any adjustments to the capital expenditure forecast must also be considered in light of the implications for safety and reliability, now and in future. ElectraNet would be pleased to provide sensitivity analysis showing the impact of changes on revenue (for both capex, contingent projects, opex and other inputs).	The CAP noted that revenue has increased significantly due to higher inflation and interest rates. It is interested to engage on these issues to understand these impacts and to consider whether the overall balance between risk and cost remains appropriate.	

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9. Contingent Projects ElectraNet proposed 3 contingent projects: • Eyre Peninsula upgrade • Network Power Quality Remediation • Interconnector upgrade Contingent projects sit outside the approved capital allowance. If defined trigger events occur, further analysis is conducted and a revenue allowance for the projects is approved by the AER if the benefits are found to outweigh the costs.	The AER has accepted the Eyre Peninsula and Network Power Quality Remediation projects, with minor amendments to trigger events. It has not accepted the interconnector upgrade because it is not considered sufficiently likely. However, any project identified as 'actionable' by AEMO in its Integrated System Plan, including an interconnector upgrade, will automatically become a contingent project under the Rules.	ElectraNet accepts the AER's refinements to trigger events for the two accepted contingent projects, and is not proposing any changes or additions to its contingent projects in the Revised Revenue Proposal.	The CAP is interested to engage further with ElectraNet on the contingent projects and their impacts and implications for customers.	
3. Insurance ElectraNet proposed a step change of $5.8m pa ($29.1m total) to address significant increases in the cost of insurance driven by Australian and global events.	The AER accepted the advice of its expert that ElectraNet's forecast cost of insurance is efficient. However, the AER reduced the step change by 51% to: • address perceived double counting relating to growth in the scale of the network • represent the difference between forecast future costs and the cost in the final year of the current period *Refer AER Draft Decision: Attachment 6, Section 6.4.3.2*	The AER accepted the basis of the step change. The AER has subsequently confirmed that the reduction relates to timing and the fact that the AER does not currently have a clear view on ElectraNet's actual insurance cost for 2022-23 (the final year of the current regulatory period). This will be updated shortly via a cost pass through application ElectraNet will submit to the AER for material increases in insurance premium costs in 2022-23. The AER expects the forecast will increase in the Final Decision based on this new information.	The CAP appeared comfortable for ElectraNet to engage with the AER on the technical differences to ensure a common understanding of the change that has been made. The CAP may want to be kept informed as this issue is worked through.	

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4. IT Cloud Migration ElectraNet proposed a step change of $1.8m pa ($9m total) to account for the costs of migrating to cloud based computing (mainly software licence fees). This program would maintain and enhance operational capabilities and deliver a range of benefits for customers not possible otherwise.	Based on expert advice from EMCa the AER concluded that: • the transition is prudent • the chosen option is likely the most efficient • the tangible benefits to ElectraNet are expected to outweigh the costs and support self-funding of the program. On this basis the AER has not accepted this step change. *Refer AER Draft Decision: Attachment 6, Section 6.4.3.4*	The implications of the Draft Decision need to be considered. It may jeopardise the program and delivery of the associated benefits for customers.	The CAP appeared comfortable ElectraNet will engage with the AER on the technical differences. The CAP may want to be kept informed as this issue is worked through.	
5. Cyber Security ElectraNet proposed a step change of $5.2m pa ($25.9m total) to improve cyber security (with $1.6m subsequently brought forward and absorbed into the current regulatory period). This involves achieving Security Profile 3 (SP3) under the Australian Energy Sector Cyber Security Framework (AESCF). This was supported by external advice from Deloitte and others on the estimated costs.	The AER agrees with ElectraNet that it is prudent to increase cyber security to level SP-3. Based on expert advice from EMCa the AER was not satisfied the forecast costs are efficient, and applied 2 reductions: • Remove the $1.6m that ElectraNet has subsequently brought forward • Remove ~$6.3m associated with roles seen as either double counted or not full-time cyber security The AER has also profiled the costs over five years (rather than flat annual figure). *Refer AER Draft Decision: Attachment 6, Section 6.4.3.3*	The need to reach SP-3 is accepted. In relation to the costs, ElectraNet: • Agrees with removing $1.6m for work that has been accelerated • Is investigating the AER's reasoning that concludes roles are double counted or not full-time ElectraNet will obtain further advice from Deloitte as to whether its cost analysis has been properly understood and analysed by EMCa. ElectraNet accepts the 'profiling' approach.	The CAP appears interested in cyber security as one of the greatest risks facing the business, but will leave ElectraNet to engage with the AER on the technical differences. The CAP may wish to be kept informed as this issue is worked through.	

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7. Capital Expenditure Sharing Scheme (CESS) The CESS is designed to encourage efficient capital investment by rewarding underspend and penalising overspend. An adjustment also avoids windfall gains from deferral of large projects. ElectraNet has sought to correct an adjustment made for a windfall gain that does not exist. The deferral of part of Project EnergyConnect has been fully offset by other project movements.	The AER did not accept ElectraNet's proposed approach. It considers the deferral of Project EnergyConnect to be material, the forecast underspend in the current period to be material and that capital expenditure in the forthcoming period has materially increased. However, it appears not to have fully considered the offsetting reprioritisation of the capital program. The result is a ~$8m CESS penalty.	ElectraNet agrees that no windfall gain should result from the deferral of Project EnergyConnect. However, as the deferral has been offset largely by reprioritising capital projects from the current regulatory period previously delayed there is no windfall gain. The Draft Decision appears inconsistent with the CESS and risks giving ElectraNet (and other transmission networks) the wrong incentives.	The CAP has previously expressed the view that ElectraNet should not obtain a windfall gain from the CESS. ElectraNet agrees. The CAP appeared comfortable for ElectraNet to engage with the AER on the technical differences. The CAP may wish to be kept informed as this issue is worked through.	