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Mr Hugo Klingenberg
Senior Manager Network Development
ElectraNet
PO Box 7096
Hutt Street Post Office
Adelaide SA 5000
Lodged by email to: consultation@electranet.com.au

Dear Mr Klingenberg

ElectraNet South Australian Energy Transformation PADR Feedback

SEA Gas welcomes the opportunity to comment on the second stage of the RIT-T for the proposed South Australian Energy Transformation, following the release of ElectraNet's Project Assessment Draft Report (**PADR**).

Given the short timeframe available, SEA Gas has not reviewed the additional materials published by ElectraNet 22 August in relation to its public consultation on the PADR. Otherwise, our main feedback in response to the PADR is attached.

In summary, SEA Gas' key concern is that the analysis completed by ElectraNet doesn't provide a sufficiently high level of confidence that forecast benefits are likely to be realised across a credible range of possible future states. In particular, we consider that further sensitivity analysis is required in relation to elevated coal prices and a higher WACC.

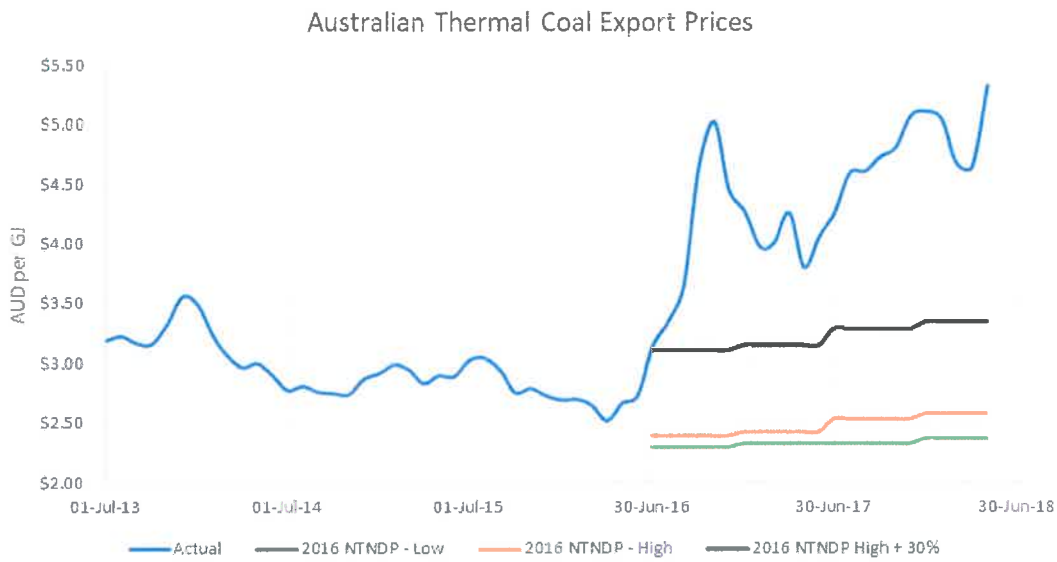
I trust that SEA Gas' submission will contribute to the robustness of ElectraNet's RIT-T assessment. Should you wish to discuss any of the points raised, please contact Paul Frederick, Head of Commercial on (08) 8236 6823.

Yours sincerely

Wendy Oldham
Chief Executive Officer

1. <u>Coal Price</u>

The Market Modelling Report indicates that coal price assumptions are largely informed by AEMO's 2016 National Transmission Network Development Plan (**2016 NTNDP**). In turn, the 2016 NTNDP assumptions were based upon forecasts developed by Wood Mackenzie in May 2016, which was at a recent low point in the context of thermal coal export prices, as shown in the following chart.



On 13 June 2018, the Minerals Council of Australia (**MCA**) published a study[1] that forecasts a 400 million tonne per annum increase in Asian demand for thermal coal by 2030. This anticipated increase is double Australia's total thermal coal export quantity recorded in 2017. The MCA study also notes that regional thermal coal supply may tighten due to Indonesia potentially diverting large volumes of product from the export market to satisfy domestic requirements for new coal-fired generating capacity due to be commissioned over the next decade. Prima facie, it would appear that these developments are likely to support continued upward price momentum for Australian thermal coal exports.

Over the same timeframe, fuel supply contracts for the Australian coal-fired generation fleet will be due for renewal. SEA Gas believes that Origin's coal supply contract for Eraring expires in 2022, and that recent short-term purchases from the Hunter Valley have been priced at export parity[2]. Similarly, it is understood that some of AGL's NSW coal contracts expire in 2025.

The May 2018 export price for Australian thermal coal was over AUD140/tonne, or around $5.30/GJ. Taking forecasts for Eraring as a conservative (i.e. high) proxy, the 2016 NTNDP implies a current range of approximately $2.40 - $2.60 per GJ for coal-fired generator fuel costs. Even allowing for a discount to coal netbacks, the 2016 NTNDP coal price assumptions are clearly too low in the context of current market conditions. While ElectraNet has tested a high coal cost sensitivity, the 30% premium applied to the 2016 NTNDP price assumptions results in a price of only ~$3.35/GJ for May 2018, based on Eraring. Again, this is considered too low relative to actual export prices recently observed.

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[1] http://www.minerals.org.au/sites/default/files/180615%20MCA%20Thermal%20Coal%20Outlook%20Study.pdf

[2] Financial Review, 28 November 2017

It is reasonable to expect that, upon expiry of current supply arrangements, the cost for new coal supply contracts for coal-fired generators will be reviewed in the context of (higher) export prices at that point. Accordingly, given that the new interconnector isn't expected to be commissioned until 2022 to 2024, it is quite possible that the fuel cost savings from coal-fired generation assumed in the PADR may not be realised.

In light of the above, SEA Gas considers that additional sensitivity analysis to higher coal prices is required in order to ensure the robustness of the RIT-T process. Based on recent export prices observed, it would appear necessary to test results at coal prices of at least $5.00/GJ.

2. Discount Rate

SEA Gas has compared ElectraNet's proposed range of real pre-tax WACC to the 10-year bond rate history, as shown in the chart below.

While ElectraNet's proposed WACC range covers fluctuations in the observed bond rate since the mid-1990s, it is materially below that which occurred over the two decades prior. SEA Gas therefore suggests that the high end of ElectraNet's proposed WACC range needs to be substantially increased unless some other form of protection (such as a cap on the allowable regulatory return) is to apply.

3. NEM Impacts

As identified in AEMO's 2016 NTNDP (section 5.3.2), additional interconnection between SA and NSW would necessitate a review of NEM market design, plus require consideration in relation to material inter-network impacts. Specifically, the NTNDP identifies that:

- models that determine transmission losses will become complex and may necessitate design changes to the NEM dispatch engine;
- inter-regional settlement residues will become more complex and may require market design solutions; and
- creating a separate AC link between South Australia and New South Wales will require a review of NEM market design.

It is unclear how these matters have been taken into account, or what ElectraNet's plan is to address them on a go-forward basis.