Government
of South Australia

Department for
Energy and Mining

Our Ref: 2022D052113

Mr Warwick Anderson
General Manager
Network Pricing
Australian Energy Regulator
GPO Box 520
CANBERRA ACT 2601

Warwick

Dear Mr ~~Anderson~~

The Energy and Technical Regulation Division (Division) of the Department for Energy and Mining (DEM) appreciates the opportunity to provide the following submission on the ElectraNet electricity transmission revenue proposal for 1 July 2023 to 30 June 2028.

The Division supports the consultative approach adopted by ElectraNet in developing its revenue proposal, the role played by the Consumer Advisory Panel (CAP) and CAP working group, and ElectraNet's willingness to acknowledge and document both strengths and weaknesses of the engagement. To make better use of meeting opportunities, obtain more constructive feedback earlier in the process, and generate richer discussions, the Division supports the CAP utilising an independent facilitator for future engagements.

The Division notes that ElectraNet's proposal seeks to recover $1709.4 million over the 2024–28 period, a 1.8% higher amount in real terms than the Australian Energy Regulator's (AER) decision for the 2019–23 period. The increase in revenue relative to the current period is driven by major capital projects in the current regulatory period, being Project EnergyConnect and the Main Grid System Strength project which have increased ElectraNet's regulatory asset base (RAB). The 2024-28 period sees a slower RAB growth, which focusses on refurbishment and replacement of aging assets and new investment in physical and cyber security, and includes little growth driven or augmentation expenditure.

The Division raises the following points with respect to the revenue proposal on matters that potentially may increase costs and reduce the delivery of benefits to consumers.

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Contingent projects

The Division notes that ElectraNet has proposed the Interconnector Upgrade Contingent project to enhance transfer capability of Project EnergyConnect. This could involve the integration of additional battery energy storage projects to deliver additional net benefits to customers. The proposed contingent project, estimated at $100m to $150m, is based on a battery size that would increase the capability of the interconnector by around 100 to 150 MW.

The electricity industry is making decisions and making announcements associated with the rapid transition of Australia's energy supply to a low carbon future. A recent example is the closure notification for the Eraring coal-fired power station. These changes to the national electricity supply mix may contribute to a need to increase interconnection capacity.

The Division notes that whilst AEMO is not currently considering a project of this nature for the 2022 Integrated System Plan (ISP), it may be possible that future ISPs could include the need for additional interconnector capability in South Australia. Under this pathway, the contingent project classification may not be required as actionable projects under a future ISP are covered separately under the new National Electricity Rules clause 5.16A.5.

The Division notes it has also proactively engaged with ElectraNet to undertake a planning study on renewable energy zone (REZ) developments in South Australia and the export capacity of electricity transmission interconnectors. This work may provide preliminary information which informs the commencement of a regulatory investment test for transmission.

In regard to the Eyre Peninsula Upgrade Contingent project, the Division notes that in its recent Independent Planning Review (Review) of ElectraNet's capital expenditure proposal for 2024-28, the Australian Energy Market Operator (AEMO) agreed that the potential overload of Cultana 275/132 kilovolt transformers needed to be addressed to accommodate future load growth in Eyre Peninsula area, with an upgrade of the Northern section of Eyre Peninsula line as one option to meet this need.

The Division notes that the Review considered that the ISP may further identify the need for the upgrade if there is substantial development in the region and therefore as noted above, an alternate pathway to the contingent project classification may be available as an actionable project.

The Division is highly conscious that the contingent projects will put further pressure on transmission costs as they result in an increase in the Regulated Asset Base and therefore considers the ISP's whole-of-system integrated roadmap for efficient development of the network as maximising end value to consumers.

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REZ design report cost pass-through

The Division notes that ElectraNet has nominated two new cost pass-through events from those included in the current regulatory control period, one of which is a 'renewable energy zone design report event'. ElectraNet proposes that expenditure for a REZ design report in one or more regulatory years is not subject to the materiality threshold that such a cost exceeds one per cent of ElectraNet's maximum allowed revenue in that regulatory year.

In its final recommendations for REZ planning, while the Energy Security Board (ESB) recommends that unanticipated REZ design reports may be nominated as a category of pass-through event for a revenue determination, "The ESB considers that the cost pass through materiality threshold should apply, as there is no obvious reason why REZ design reports should be treated differently from other forms of cost pass through event."[1] Reinforcing the ESB's recommendation, the Division would propose that the arrangements for materiality threshold remain and should not be waived.

Further, ElectraNet has proposed an operating expenditure step change which includes recurrent costs related to the REZ planning rules passed into law on 13 May 2021. ElectraNet has indicated that these ongoing costs are distinct from the cost of preparing REZ design reports, however ElectraNet has not outlined how these costs are able to be kept separate to ensure cross-subsidisation does not occur.

Step change components of operating expenditure

The Division acknowledges that price pressures are likely to have persisted for expenditure components such as cyber security, insurance, and information technology. The Division also notes the engagement that ElectraNet has undertaken with stakeholders to, in some cases, reduce the extent of this expenditure growth proposed from the time of the release of the preliminary revenue proposal in October 2021 and January 2022.

Nevertheless, as identified in the AER Issues Paper, verification of these estimated increases should be undertaken by the AER to ensure that the scale of these operating expenditure step-changes is consistent with industry benchmarks. Additionally, to ensure consistency with the AER's cost allocation guidelines and the requirements of the National Electricity Law and Rules, AER verification should ensure these costs are allocated appropriately to the regulated segment of the business.

With respect to the operating expenditure step-change associated with "migration to the cloud", the Division notes that this component "...involves a capex/opex trade off, which is appropriately addressed through a step change to cover the cost of additional licence fees,

[1] Energy Security Board, Renewable Energy Zones Planning, Final Recommendations, February 2021, p.16.

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which is more than offset by capital cost savings and other benefits."[2] The Division considers that these corresponding Information Technology (IT) capital expenditure savings should be identified in the proposal and the reasoning for classifying these costs as operating, rather than capital expenditure.

The Division notes that ElectraNet has outlined a net transfer of $46 million from its capital expenditure forecast to operating expenditure forecast, resulting from the requirement that intangible assets must be reported as operating expenditure moving forward. While understanding that these are principally IT investments, a clearer itemisation of these intangible assets would improve the clarity and transparency of this element of the proposal.

If you have any further queries, please contact Mr Andrew Schultz on 8429 4848.

Yours sincerely

Vince Duffy

EXECUTIVE DIRECTOR, Energy and Technical Regulation

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[2] ElectraNet, Attachment 6: Operating Expenditure – Revenue Proposal 2023-24 to 2027-28, p. 22