AusNet services

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Sebastian Roberts
General Manager – Networks Branch
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Dear Sebastian,

AusNet Services' Transmission – Revised Revenue Proposal

AusNet Services submitted its Revised Revenue Proposal for the 2017-22 regulatory period on 21 September 2016. This further submission is provided to:

- Adopt the AER's Guideline approach to implementing the new cost of debt approach, reducing the proposed rate of return by around 1.3 percentage points.
- Update AusNet Services' Revised Revenue Proposal to reflect recent developments in the Latrobe Valley;
- Note relevant aspects of SAPN's application for Judicial Review of the ACT Decision in relation to gamma;
- Reduce AusNet Services' operating expenditure forecast to account for savings expected to result from the retirement of diesel generators;
- Inform the AER of a significant increase to the Victorian Government's easement land tax; and
- Flag to the AER that amendments to AusNet Services' STPIS data will be provided to correctly reflect the application of the unplanned outage event limit.

Many of the developments raised in in this submission are due to circumstances outside of AusNet Services' control, which have occurred since the submission of the Revised Revenue Proposal. Importantly, where the changes have been initiated by AusNet Services, they significantly reduce proposed revenues for the forthcoming period.

AusNet Services recognises the submission of additional information late in the regulatory review process is undesirable. However, the deferred publication date of the Final Decision, which AusNet Services understands to be 28 April 2017, should provide sufficient time for the AER to consider and consult on the additional information presented in this submission.

We will seek to engage with the Consumer Challenge Panel (CCP) on the information set out in this submission, and have provided a copy of the submission to the CCP for its consideration. AusNet Services would support the AER conducting further consultation with customers on this information.

Cost of debt and inflation

On 9 December 2016, AusNet Services wrote to the AER advising of our intent to propose a cost of debt transition consistent with the AER's Guideline in our 2018-22 Gas Access Arrangement Review Proposal (submitted to the AER on 16 December) and to withdraw the immediate transition cost of debt approach from our Transmission Revised Revenue Proposal for the 2017-22 regulatory control period.

This commitment removes uncertainty on over $170 million of potential transmission revenue and ensures transmission customers will not bear the burden of its recovery.

Accordingly, this letter formally amends AusNet Services' Transmission's Revised Revenue Proposal in the following respects:

- The immediate transition approach to the cost of debt is withdrawn; and
- A cost of debt transition consistent with the AER's Guideline is proposed.

However, AusNet Services maintains the position set out in our Revenue Proposal and Revised Revenue Proposal that the return on debt should be calculated using the Reserve Bank of Australia 10-year curve exclusively.

AusNet Services' proposal in relation to the cost of equity and inflation also remains unchanged. However, we note that on 15 December 2016, the AER announced a review in respect of its methodology for estimating expected inflation. AusNet Services supports the review and encourages the AER to take the review into account in making its Final Decision for the TRR.

As the AER will be aware, AusNet Services' final averaging period has now passed. On the basis of the application of our revised position on the cost of debt applied over the final averaging period, the table below sets out our updated rate of return proposal. The Revised Revenue Proposal's rate of return parameters are also shown, which demonstrate that AusNet Services' updated rate of return is a reduction of around 1.3 percentage points.

Table 1: Revised Revenue Proposal - Updated Rate of Return and Forecast Inflation

Parameters	Revised Revenue Proposal	Revised Revenue Proposal - amended
Return on Equity		
Risk free rate	1.97%*	2.52%
Equity beta	0.7	0.7
Market risk premium	7.5%	7.5%
Proposed Return on Equity	**7.20%**	**7.77%**
Return on Debt		
Immediate transition w/ RBA curve	**7.56%**	
AER Guideline transition w/ RBA curve		**5.03%**

Parameters	Revised Revenue Proposal	Revised Revenue Proposal - amended
Proposed WACC	**7.41%**	**6.13%**
Breakeven inflation forecast	**1.65%**	**1.86%**
Alternative approach to deriving Nominal WACC		
Proposed Alternative WACC	**8.24%**	**6.65%**

***Observed over a placeholder averaging period of 1 to 28 July 2016.*

The data and calculations underpinning the updated WACC parameters are provided at Attachment 1. An amended revenue forecast (and PTRM) incorporating these parameters will be provided to the AER in January 2017.

Latrobe Valley developments

AusNet Services' Revised Revenue Proposal included accelerated depreciation of connection assets located at Yallourn Power Station (YPS) on the basis that the power station was likely to close by 2025. This increased forecast revenues by $5 million (nominal).

In November 2016, Engie announced its intention to close Hazelwood Power Station (HWPS) in March 2017, providing greater certainty on the future of Latrobe Valley generation assets. AusNet Services, therefore, accepts that the closure of YPS by 2025 is unlikely, having regard to the market impacts of HWPS closure. Accordingly, AusNet Services withdraws the accelerated depreciation of YPS assets from its Revised Revenue Proposal, reducing forecast revenues by $5 million (nominal).

To ensure other customers' interests are protected, AusNet Services intends to seek to recover the remaining value of the connection assets at HWPS directly from Engie. This means AusNet Services will incur a tax liability which will need to be included in the tax allowance for the forthcoming period.

It is expected the net revenue impact of the above developments is positive for customers, in that it should reduce forecast revenues by $2 million. AusNet Services' estimated net impact is shown below.

Table 2: Estimated net revenue impact of Latrobe Valley developments ($m, nominal)

	Revenue impact
Withdrawal of YPS accelerated depreciation	- $5 million
Inclusion of tax allowance for HWPS payment*	+ $3 million*
Net revenue impact	**- $2 million***

* Figures to be confirmed in January 2017

An amended PTRM incorporating the above change will be provided in January 2017.

Gamma

For the reasons set out in our Revenue Proposal and Revised Revenue Proposal, AusNet Services maintains that the appropriate estimate of the value of imputation credits is 0.25.

AusNet Services is aware of the recent Tribunal decision in relation to SA Power Networks. However, AusNet Services also notes that decision is the subject of a judicial review application by SA Power Networks, including on grounds that the Tribunal did not determine the correct question, being the construction of the Rules relating to the value of imputation credits. We also note the judicial review application by the AER in respect of the Tribunal's decision in Ausgrid also remains outstanding.

Operating expenditure savings

In December 2016, AEMO confirmed that the services provided by diesel generators at four of AusNet Services' terminal stations will no longer be required from 1 January 2017. Accordingly, AusNet Services' operating expenditure forecast for the forthcoming period is formally amended to reflect the retirement of these assets via:

- A reduction of $55,000 in 2017-18 to reflect the avoided costs from 1 January 2017 to 31 March 2018; and
- An annual reduction of $44,000 from 2018-19 to 2021-22.

AEMO's correspondence on this matter is provided at Attachment 2.

An amended opex model and PTRM incorporating these changes will be provided in January 2017.

Easement Land Tax

On 14 December 2016, the State Revenue Office of Victoria (SRO) advised that AusNet Services' easement land tax payable in 2017-18 and 2018-19 would be approximately $136 million. The formal assessment notice will be provided by the SRO in January 2017.

Unfortunately, AusNet Services was not forewarned about this significant and unexpected increase, which represents a $25 million (23%) increase on the easement land tax paid in 2016-17 of $111 million. It is also approximately $22 million higher than the easement land tax forecast of $114 million (real 2016-17) determined by the AER in the Draft Decision.

AusNet Services is currently exploring options to manage a significant increase to the easement land tax, and would welcome the opportunity to engage with the AER on this issue.

Amended STPIS data

AusNet Services' Revised Revenue Proposal set out STPIS V5 Market Impact Component performance measure data from 2008-15 that assumed the unplanned outage event limit applied to the dispatch intervals associated with *individual* unplanned outage events.[1]

The AER has since advised that the unplanned outage event limit applies to *annual* total dispatch intervals attributable to unplanned outages in a given year. AusNet Services will recalculate its 2008-15 performance measure data and provide this to the AER in January 2017.

AusNet Services would be pleased to discuss matters raised in this submission with the AER and interested stakeholders. Please contact Rob Ball, Senior Economist on 03 9695 6281 with any inquiries.

Sincerely,

Tom Hallam
General Manager Regulation and Network Strategy
AusNet Services

[1] AusNet Services, *Revised Revenue Proposal 2017-22*, September 2016, p.219