Attachment 1

Maximum Allowed Revenue

Revenue Proposal 2023-24 to 2027-28

31 JANUARY 2022

Company Information

ElectraNet Pty Ltd (ElectraNet) is the principal electricity transmission network service provider (TNSP) in South Australia.

For information about ElectraNet visit www.electranet.com.au.

Contact

For enquiries about this Revenue Proposal please contact:

Simon Appleby
Manager Regulation and Investment Planning
ElectraNet
52-55 East Terrace
Adelaide SA 5000

revenue.reset@electranet.com.au

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Note

This attachment forms part of our Revenue Proposal for the 2023-24 to 2027-28 regulatory period. It should be read in conjunction with the other parts of the Revenue Proposal.

Our Revenue Proposal comprises the overview and attachments listed below, and the supporting documents that are listed in Attachment 14:

- Revenue Proposal Overview
- Attachment 1 – Maximum allowed revenue (this document)
- Attachment 2 – Regulatory asset base
- Attachment 3 – Rate of return
- Attachment 4 – Regulatory depreciation
- Attachment 5 – Capital expenditure
- Attachment 6 – Operating expenditure
- Attachment 7 – Corporate income tax
- Attachment 8 – Efficiency benefit sharing scheme
- Attachment 9 – Capital expenditure sharing scheme
- Attachment 10 – Service target performance incentive scheme
- Attachment 11 – Pricing methodology
- Attachment 12 – Pass through events
- Attachment 13 – Demand Management Innovation Allowance
- Attachment 14 – List of supporting documents

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1. Maximum Allowed Revenue

1.1 Key points

- Our Maximum Allowed Revenue (MAR) reflects the sum of the revenue building blocks – namely the return on capital, return of capital (depreciation), operating expenditure, efficiency incentive payments, and corporate tax allowance.
- Our revenue requirement is calculated in accordance with the standard post-tax building block approach outlined in the Rules using the AER's Post-Tax Revenue Model (PTRM).
- Our proposed X factors have been calculated in accordance with Rules. Table 1.1 below shows the MAR and the X factors proposed for the 2023-24 to 2027-28 regulatory period. For reference, our MAR for the final year of the current regulatory period is also shown.

Table 1.1: Smoothed revenue requirement, 1 July 2022 to 30 June 2028 ($m nominal)

	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	2024-28 Total
Annual expected MAR (Smoothed)	347.8	350.0	358.4	367.0	375.8	384.8	1835.9
X factor	N/A	0%	0%	0%	0%	0%	

- Our revenue requirement is 0.6% higher in nominal terms or 1.7% lower in real terms in 2023-24 (the first year of the forthcoming regulatory period) compared to the prior year. Due to revenue smoothing it then remains constant in real terms, increasing in nominal terms at 2.40% per annum, which is the estimated rate of inflation. Actual revenue will be updated annually by the AER for the prevailing cost of debt and other annual adjustments[1].
- The overall trend in revenue is driven primarily by:
  - major capital projects in the current regulatory period driven by AEMO's Integrated System Plan which are built into the RAB – namely Project EnergyConnect and the Main Grid System Strength project. These increase our annual revenue requirement over the forthcoming regulatory period by approximately $15 million per annum;
  - our operating expenditure requirement, which is affected by increased external costs, including new cyber security obligations and significant increases in insurance premiums; and
  - the offsetting impact of a reduced capital program and lower regulated rate of return as reflected in the Weighted Average Cost of Capital (WACC).
- We estimate that average transmission charges will increase by approximately 3.3% in nominal terms from approximately 3.2 cents per kWh in 2022-23 to approximately 3.3 cents per kWh in 2023-24, equivalent to an increase of 0.8% in real terms.
- For an average residential customer, this translates to an annual increase of approximately $5 ($ nominal) in their electricity bill in 2023-24. We expect that this increase will be more than offset by reductions in wholesale electricity prices made possible by the two ISP projects

[1] These include incentive bonus or penalty payments under the Service Target Performance Incentive Scheme and payments under the Demand Management Innovation Allowance Mechanism, which are excluded from the headline figures presented here.

mentioned above, which are expected to reduce South Australian annual household electricity bills by over $100 per customer.

- Within the forthcoming regulatory period we expect average transmission charges to increase by 3.3% in real terms to 2027-28, subject to ongoing revenue adjustments and changes in customer energy consumption.
- In response to customer feedback, we have also examined the sensitivity of our revenue outlook to movements in interest rates. Under a high interest rate scenario in which we set WACC to 4.63% rather than the 4.29% otherwise based on market information, transmission charges would increase by 10.6% in real terms from 2022-23 to 2027-28 from the impact of higher interest rates on our regulated rate of return.

1.2 Introduction

This Attachment sets out our MAR for prescribed transmission services and other key aspects of our Revenue Proposal. The MAR is calculated in accordance with the standard post-tax building block approach outlined in Part C of Chapter 6A of the Rules and the PTRM.[2]

The Attachment is structured as follows:

- Section 1.3 defines the scope of the services covered by the MAR and by this Revenue Proposal.
- Section 1.4 sets out other key aspects of our Revenue Proposal.
- Section 1.5 provides an overview of the methodology used to calculate the MAR.
- Section 1.6 sets out summary information on the opening Regulated Asset Base (RAB) and forecast RAB values used in the revenue calculations.
- Section 1.7 provides summary information on the return on capital.
- Section 1.8 sets out information on regulatory depreciation.
- Section 1.9 shows our annual operating expenditure requirements.
- Section 1.10 sets out details of the incentive payments from the current period that are included in our annual revenue requirement for the forthcoming regulatory period.
- Section 1.11 sets out the corporate tax allowance.
- Section 1.12 provides details of our shared asset revenue.
- Section 1.13 shows the calculations of the annual building block revenue requirement.
- Section 1.14 sets out the MAR and X factors for the forthcoming regulatory period.
- Section 1.15 shows the average price path under our proposed MAR.

[2] PTRM version 3

1.3 Scope of services covered

The MAR relates to the costs of prescribed transmission services. Costs have been allocated to prescribed services in accordance with our approved Cost Allocation Methodology.[3]

Prescribed services comprise:

- Prescribed exit services which are connection services provided to SA Power Networks and transmission customers (including under legacy arrangements).
- Prescribed entry services which are connection services provided to some generators under legacy arrangements.
- Prescribed transmission use of system (TUOS) services which are shared to a greater or lesser extent by customers across the transmission system.
- Prescribed common transmission services which are provided to all transmission customers regardless of location, and therefore cannot reasonably be allocated on a locational basis.

For the avoidance of doubt, the revenues associated with negotiated transmission services are excluded from the MAR. Similarly, other services we provide (non-regulated transmission services) are not subject to economic regulation under Chapter 6A of the Rules and are therefore also excluded from the MAR.

1.4 Revenue Proposal details

1.4.1 Period over which the MAR applies

The MAR applies for the five year regulatory control period commencing on 1 July 2023 and ending on 30 June 2028.

1.4.2 Lodgement date

ElectraNet is required to lodge a Revenue Proposal by 31 January 2022, being 17 months prior to the expiry of the current regulatory period (i.e. 30 June 2023) under clause 6A.10.1(a) of the Rules.

1.4.3 Capitalisation

Expenditure has been allocated to capital and operating expenditure in accordance with our capitalisation policy. No changes are proposed to our capitalisation policy at this time.

While our capitalisation policy will remain unchanged, the impact on our expenditure forecasts of recent accounting treatment changes that require us to report intangible assets as operating expenditure are explained in Attachments 5 and 6.

1.4.4 Presentation of numbers

In our Revenue Proposal, unless stated otherwise, forecast and historical expenditure is expressed in real terms (excluding inflation) in 2022-23 dollars to enable comparison of trends.

The reference date for escalation is 30 June (i.e. mid financial year values) unless otherwise indicated.

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3 Available at https://www.electranet.com.au/wp-content/uploads/resource/2016/06/20081508-Report-Cost-Allocation-Methodology.pdf.

The exception is that the RAB and revenue building blocks are presented in nominal dollars (including inflation) consistent with the PTRM. The nominal figures presented in this Attachment are expressed in end of year ($June) terms.

Totals presented in table rows and columns throughout this Revenue Proposal may not necessarily add due to rounding.

1.4.5 Confidential information

We have not identified any aspects of this Revenue Proposal as confidential. Where a claim of confidentiality is made in relation to a supporting document listed in Attachment 14, a redacted version is provided along with details of the confidential information.

Our Revenue Proposal, including supporting material, comprises a total of 1,025 pages of written material, of which 102 pages include confidential information we are unable to disclose, representing only 10% of the total.

Further information is contained in the confidentiality register which accompanies our Revenue Proposal.

1.4.6 Related Party Transactions

We confirm that ElectraNet is not a related party to any other entity which contributes to the provision of prescribed transmission services, or with the capacity to determine the outcome of decisions about ElectraNet's financial and operating policies. Accordingly, there are no contracts in place for the provision of services by any such entities.[4]

1.5 Methodology

Our MAR is calculated using the standard post-tax building block approach outlined in clause 6A.5.4 of the Rules and the PTRM and accompanying handbook.

The revenue building block components are described in detail in the other attachments that comprise our Revenue Proposal. We have applied an inflation forecast of 2.40% for the forecast period as explained in Attachment 3.

The building block formula to be applied in each year of the regulatory control period is:

MAR	=	return on capital + return of capital + Operating expenditure + Tax +/- Incentive payments
	=	(WACC x RAB) + D + Operating expenditure + Tax +/- Incentive payments

where:

MAR	=	Maximum Allowable Revenue
WACC	=	post tax nominal Weighted Average Cost of Capital ('vanilla' WACC)
RAB	=	Regulatory Asset Base
D	=	economic depreciation (= nominal depreciation – indexation of the RAB)
Operating expenditure	=	operating expenditure

4 For completeness, ElectraNet reports the payment of Directors' fees and interest on shareholder loan notes as related party transactions for the purposes of its annual regulatory financial reporting to the AER, consistent with our statutory reporting. ElectraNet Transmission Investments Pty Ltd as a related party owns certain negotiated and unregulated assets but does not provide any prescribed transmission services.

Tax	=	regulated business corporate tax allowance
Incentive payments	=	Efficiency Benefit Sharing Scheme (EBSS) and Capital Expenditure Sharing Scheme (CESS)

The revenue calculated using the building block formula is smoothed with an X factor in accordance with the requirements of clause 6A.6.8 of the Rules.

Other revenue adjustments are applied separately such as annual incentive scheme payments under the STPIS (including the NCIPAP) and payments under the Demand Management Innovation Allowance Mechanism (DMIAM) together with annual updates to the cost of debt by the AER and annual adjustment for actual inflation.

1.6 Regulatory asset base

The opening RAB as at 1 July 2023 has been calculated in accordance with the Rules requirements and the AER's Roll Forward Model (RFM). In accordance with clause 11.6.11, several connection assets that previously benefitted from grandfathering provisions no longer do so. These assets have therefore been removed from the opening RAB and the services they provide will be reclassified as negotiated transmission services in the forthcoming regulatory period following changes to the relevant connection agreements.

A projection of the RAB is required for each year of the forthcoming regulatory period to calculate the annual return on capital building block. The projected RAB values over the forthcoming regulatory period are set out in Table 1.2 below. These values reflect the capital expenditure forecast set out in Attachment 5 and the forecast regulatory depreciation over the period as described in Attachment 4.

Table 1.2: Asset base roll-forward from 1 July 2023 to 30 June 2028 ($m nominal)

Asset base	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Opening RAB	3593.7	3691.2	3781.4	3859.1	3925.8	
Net capital expenditure	157.3	164.7	152.0	147.2	130.8	**752.0**
Straight line depreciation	-146.2	-163.0	-165.0	-173.1	-171.6	**-818.9**
Inflation adjustment on RAB	86.2	88.6	90.8	92.6	94.2	**452.4**
Closing RAB	3691.2	3781.4	3859.1	3925.8	3979.2	

1.7 Return on capital

As noted in section 1.5, the annual return on capital building block is calculated by multiplying the projected RAB by the allowed rate of return or WACC. Our WACC parameter values, which are explained in Attachment 3, are summarised in Table 1.3 below.

Table 1.3: Proposed rate of return and inflation

Parameters	Proposal
Risk free rate	1.37%
Equity beta	0.6
Market risk premium	6.1%
Return on equity	5.00%
Return on debt	3.82%
Inflation	2.40%
Gearing ratio	60%
Gamma	0.585
Corporate Tax rate	30%
Nominal vanilla WACC	**4.29%**

The return on capital has been calculated by applying the nominal vanilla WACC to the opening RAB consistent with the PTRM.[5] This calculation is shown in Table 1.4 below.

Table 1.4: Return on capital from 1 July 2023 to 30 June 2028 ($m nominal)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Opening RAB	3593.7	3691.2	3781.4	3859.1	3925.8	
Return on capital	154.2	158.4	162.3	165.6	168.5	**809.1**

1.7.1 Equity raising costs

We have applied the AER's standard approach to forecast equity raising costs in the PTRM. This has resulted in a forecast of $0 in equity raising costs in the forthcoming regulatory period.

1.8 Regulatory depreciation

Our calculation of regulatory depreciation (or return of capital) is set out in Attachment 4.

The PTRM calculates regulatory depreciation by subtracting the indexation of the opening asset base from the depreciation for each regulatory year. A summary of this calculation is shown in Table 1.5 below.

Table 1.5: Regulatory depreciation from 1 July 2023 to 30 June 2028 ($m nominal)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Straight line depreciation	146.2	163.0	165.0	173.1	171.6	**818.9**
Inflation adjustment on RAB	86.2	88.6	90.8	92.6	94.2	**452.4**
Regulatory depreciation	59.9	74.4	74.3	80.5	77.4	**366.5**

5 As noted in Attachment 3, the WACC used for the purpose of this Revenue Proposal is based on an indicative averaging period for the risk-free rate and debt risk premium, based on the AER's 2018 Rate of Return Instrument. This instrument will be revised in December 2022 and, therefore, our estimated rate of return needs to be updated prior to the AER's final decision, in accordance with the requirements of the 2022 Rate of Return Instrument. It is currently expected that the WACC will also be updated on an annual basis during the forthcoming regulatory period, consistent with the application of a 10-year trailing average cost of debt by the AER.

1.9 Operating expenditure

An explanation of our operating expenditure requirements is provided in Attachment 6. The total operating expenditure is shown in Table 1.6 below.

Table 1.6: Operating expenditure from 1 July 2023 to 30 June 2028 ($m nominal)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure	123.7	130.1	133.5	136.7	139.9	663.9
Debt raising costs	1.8	1.8	1.9	1.9	2.0	9.4
Total	125.5	132.0	135.3	138.6	141.9	673.3

1.10 Incentive payments

Under the applicable incentive schemes, efficiency bonuses or penalty payments are determined based on performance against established targets. The operation of these schemes is described further in the relevant Attachments.

Our revenue forecast includes payments to be made in the forthcoming regulatory period under the following incentive arrangements:

- EBSS – bonus/ penalty payments made to reflect operating expenditure efficiency performance in the current regulatory period; and
- CESS – bonus/ penalty payments made to reflect capital expenditure efficiencies in the current regulatory period.

The contribution of these payments to total forecast revenue is shown in Table 1.7 below.

Table 1.7: Incentive payments from 1 July 2023 to 30 June 2028 ($m nominal)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
EBSS	-2.9	1.1	3.6	0.0	-1.6	**0.2**
CESS	-2.3	-2.3	-2.4	-2.4	-2.5	**-11.9**
Total	-5.2	-1.3	1.3	-2.4	-4.1	-11.7

In addition to these schemes, we will continue to be subject to the Service Target Performance Incentive Scheme in the forthcoming regulatory period with annual revenue adjustments to be applied as required, together with approved payments under the Demand Management Innovation Allowance Mechanism.

1.11 Corporate tax allowance

The calculation of the corporate tax allowance is presented in Attachment 7. Our estimate of the value of imputation credits (gamma) is set out in Attachment 3. The corporate tax allowance is shown in Table 1.8 below.

Table 1.8: Tax allowance from 1 July 2023 to 30 June 2028 ($m nominal)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Tax payable	0.0	0.0	0.0	0.0	0.0	**0.0**
Less value of imputation credits	0.0	0.0	0.0	0.0	0.0	**0.0**
Corporate tax allowance	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

1.12 Shared asset revenue

The AER's Shared Asset Guideline requires a revenue adjustment to be made if the average annual non-regulated revenue from shared assets that provide both prescribed transmission services and non-regulated services exceeds a materiality threshold of 1% of total smoothed revenue over the regulatory period. This Guideline does not apply where the approved Cost Allocation Methodology has been applied.

Table 1.9 below sets out the applicable revenue from non-regulated services using shared assets.

Table 1.9: Shared asset revenue from 1 July 2023 to 30 June 2028 ($m nominal)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Shared Asset Revenue	2.1	2.2	2.3	2.5	2.7	**11.8**
Average annual Shared Asset Revenue	2.4	2.4	2.4	2.4	2.4	**11.8**
Smoothed MAR	350.0	358.4	367.0	375.8	384.8	**1835.9**
% of Smoothed MAR	0.60%	0.61%	0.63%	0.67%	0.70%	

Applying the materiality test, the 1% threshold will not be exceeded in the forthcoming regulatory period, and a revenue adjustment for shared assets will therefore not be required.

1.13 Annual building block revenue requirement

The annual building block revenue requirement for each year of the forthcoming regulatory period is calculated in accordance with clause 6A.5.4 of the Rules as the sum of the building blocks – namely return on capital, return of capital (regulatory depreciation), operating expenditure, efficiency bonuses or penalties, and corporate tax allowance.

Table 1.10 overleaf presents a summary of the building blocks and the annual building block revenue requirement.

Table 1.10: Annual building block revenue requirement 1 July 2023 to 30 June 2028 ($m nominal)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Return on capital	154.2	158.4	162.3	165.6	168.5	**809.1**
Return of capital (regulatory depreciation)	59.9	74.4	74.3	80.5	77.4	**366.5**
Operating expenditure	125.5	132.0	135.3	138.6	141.9	**673.3**
Incentive payments	-5.2	-1.3	1.3	-2.4	-4.1	**-11.7**
Corporate tax allowance	0.0	0.0	0.0	0.0	0.0	**0.0**
Annual building block revenue requirement	334.5	363.5	373.2	382.3	383.7	**1837.2**

1.14 Maximum allowed revenue and X factors

In accordance with clauses 6A.5.3(c) and 6A.6.8 of the Rules, the annual building block revenue requirement is converted into a MAR in order for the revenue cap to be implemented. We have applied the standard revenue smoothing approach in the PTRM.

The X factors we propose are consistent with the approach applied by the AER throughout the current regulatory control period and comply with the Rules requirements because:

- The MAR in the last year of the forthcoming regulatory period (the year ending 30 June 2028) is within 0.1% of the annual building block revenue requirement for that year. This is consistent with clause 6A.6.8(c)(2) which requires the X factor to be set so that these two values are as close as reasonably possible.
- The total building block revenue and the total MAR for the regulatory period (that is, the total revenue cap) are equal in net present value terms, as required by clause 6A.5.3(c)(1).

Table 1.11 below shows the annual building block revenue requirement, the MAR, the X factors, and the total revenue cap for the forthcoming regulatory period.

Table 1.11: Smoothed revenue requirement, 1 July 2023 to 30 June 2028 ($m nominal)

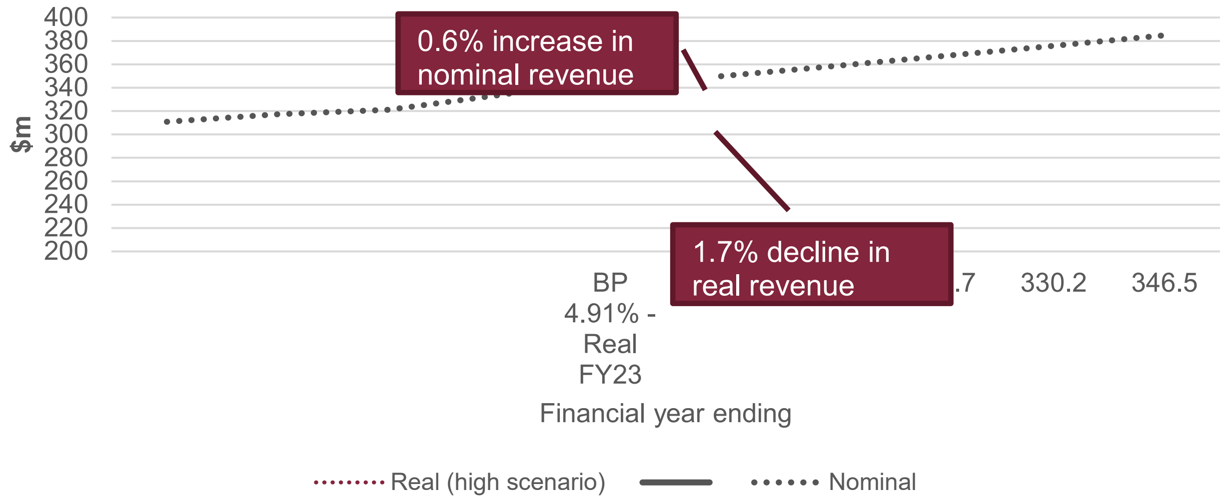
	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Annual building block revenue requirement (Unsmoothed)	334.5	363.5	373.2	382.3	383.7	**1837.2**
Annual expected MAR (Smoothed)	350.0	358.4	367.0	375.8	384.8	**1835.9**
X factor	1.73%	0%	0%	0%	0%	

Figure 1.1 below shows an increase in our nominal revenue path in the first year of the forthcoming regulatory period of 0.6%, equivalent to a 1.7% decline in real revenue.

For illustration, it also shows the sensitivity of our revenue outlook to movements in interest rates. Under a high interest rate scenario based on market information[6], the first year revenue increase would be 4.4%.

[6] Based on a risk free rate of 2.50% from 2024.

Figure 1.1: Revenue path ($m)



1.15 Average price path

We determine our annual transmission charges based on revenues approved by the AER and our approved Pricing Methodology. The effect of our Revenue Proposal on average transmission charges can be approximated by taking the MAR and dividing it by forecast delivered energy in South Australia.

Based on this approach, we estimate that our Revenue Proposal will result in an increase of about 3.3% in nominal terms (equivalent to a 0.8% real increase) in transmission charges for the typical South Australian residential electricity customer in the first year of the forthcoming regulatory period and a total increase of 13.6% over the period in nominal terms, or 3.3% in real terms over the full period.

It should be noted that many customers will experience changes that differ from this average. We also expect these upward movements to be more than offset by falls in total electricity prices made possible by the two ISP investments mentioned above, the costs of which are reflected in these transmission charges.

Figure 1.2 below shows the average price path resulting from this Revenue Proposal during the next regulatory period compared with the average price for the current regulatory period (2018-19 to 2022-23).

Figure 1.2: Average price path ($/MWh)

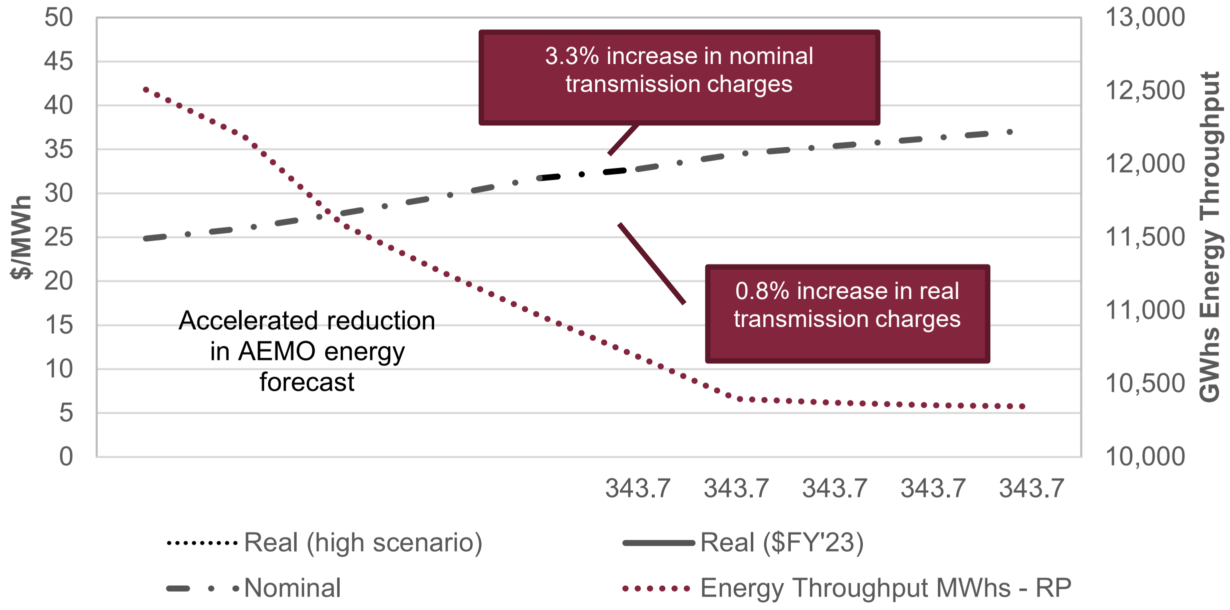


Table 1.12 below shows the average price path over the forthcoming regulatory period.

Table 1.12: Average price path ($m nominal)

	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Smoothed revenue requirement	347.8	350.0	358.4	367.0	375.8	384.8
Energy (GWh)	10,964	10,685	10,396	10,369	10,354	10,345
Average transmission price ($/MWh, nominal)	31.7	32.8	34.5	35.4	36.3	37.2
Average transmission price ($/MWh, real)	31.7	32.0	32.9	33.0	33.0	33.0
Average transmission price ($/MWh, real, high scenario)	31.7	*34.0*	*34.9*	*35.0*	*35.1*	*35.1*

We estimate that the increase in our transmission charges in the first year of the forthcoming regulatory period would add approximately $5 to the average residential customer's annual electricity bill and approximately $10 to the average small business customer's bill (in nominal terms). However, this increase will be offset by substantial savings in wholesale prices as a result of delivering Project EnergyConnect, which is expected to reduce annual electricity costs by approximately $100 per residential customer and $200 per small business customer.

Actual revenue and price outcomes by the end of the period will be influenced by a number of factors including annual movements in energy consumption, inflation and the WACC as the actual cost of debt (assuming the current AER Guideline approach) is updated annually throughout the period.

Again, for illustration we have shown above the sensitivity of the price outlook to movements in interest rates. Under the high interest rate scenario shown in our revenue outlook above, transmission charges would increase by 10.6% in real terms from 2022-23 to 2027-28.

These revenue and pricing outcomes exclude the impact of any additional projects (known as 'contingent projects') that may be approved separately by the AER if certain trigger events are met.

We have identified three contingent projects in our Revenue Proposal, and also noted that further contingent projects may arise during the forthcoming regulatory period, if identified as being required by AEMO's Integrated System Plan or as a system strength project in accordance with Rule 11.143.18. If one or more contingent projects proceed, our revenue requirements will increase from the amounts presented in this Revenue Proposal. Such projects are subject to separate consultation and approval by the AER and are only approved if determined to be in the long term interests of electricity customers, such that their cost is more than outweighed by benefits.

ElectraNet