Para Substation

Attachment 6

Operating Expenditure

Revenue Proposal 2023-24 to 2027-28

31 JANUARY 2022

ElectraNet

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.

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Note

This attachment forms part of our Revenue Proposal for the 2023-24 to 2027-28 regulatory control 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
- Attachment 2 – Regulatory asset base
- Attachment 3 – Rate of return
- Attachment 4 – Regulatory depreciation
- Attachment 5 – Capital expenditure
- Attachment 6 – Operating expenditure (this document)
- 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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6. Operating Expenditure

6.1 Key points

- In like terms, our operating expenditure is forecast to increase 9% compared to the current regulatory period. Excluding step changes driven by externally imposed costs, our underlying operating expenditure is expected to reduce by 4% compared to the current regulatory period.
- We have applied the AER's base-step-trend methodology to derive our operating expenditure forecasts, consistent with the approach set out in the Expenditure Forecast Assessment Guideline[1] and as set out in our Expenditure Forecast Methodology previously submitted to the AER[2].
- With the completion of the Eyre Peninsula Link we will no longer need to provide network support to Port Lincoln and the Eyre Peninsula. Therefore, the current network support allowance, which is approximately $11m per annum, has been removed from our forecast. This is partly offset by increases driven by network growth, which add to the operating expenditure requirement through the circuit length element of the rate of change component of the AER's forecasting method. The net effect is that our underlying operating expenditure is forecast to be lower than current levels.
- In addition to these movements, several external factors outside of our control continue to create upward cost pressures, including:
  - Bushfires and other global events in recent years causing projected insurance costs to increase substantially;
  - New critical infrastructure legislation regarding increased cyber security requirements;
  - New Rules obligations driving a need for increased specialist resourcing in areas such as network planning; and
  - The requirement to migrate some of our information technology systems to the Cloud to maintain and enhance functional capabilities brings with it increasing licensing costs.
- Therefore, in relation to step changes, we are proposing increases in relation to insurance; cyber security; migration to the Cloud; and recent rule changes. In total these step changes will add approximately $13.8 m to our total operating expenditure over the next 5 years.
- In the current regulatory period, we did not propose any step changes and absorbed significant ongoing cost increases above the AER's allowance. This approach is not sustainable in the 2023-24 to 2027-28 regulatory period.
- Our operating expenditure forecasts reflect prudent and efficient costs, in accordance with the requirements of the Rules, built on the savings we have delivered to date, notwithstanding the need to overspend the AER allowance. We will continue to work hard to manage and operate South Australia's transmission network as efficiently as possible, to support the safe, secure and reliable supply of electricity.

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1 *Better Regulation: Expenditure Forecast Assessment Guideline for Electricity Transmission*, Australian Energy Regulator, November 2013 available at www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/expenditure-forecast-assessment-guideline-2013.

2 ElectraNet, *Expenditure Forecast Methodology: Regulatory Control Period 2018-19 to 2022-23*, June 2016, available at www.electranet.com.au/wp-content/uploads/report/2016/09/20160630-Report-ElectraNetExpenditureForecastMethodology.pdf.

- Recent accounting treatment changes require us to report intangible assets as operating expenditure moving forward. This results in a net transfer of $46m from our capital expenditure forecast to our operating expenditure forecast, principally impacting on our technology investments. Our Revenue Proposal Overview presents our expenditure forecasts prior to this adjustment for like comparison, while the remainder of this attachment presents our forecasts after this adjustment unless otherwise specified.

6.2 Introduction

This attachment presents information on our operating expenditure forecast for the forthcoming regulatory period. The information and calculations presented in this attachment meet the requirements of the Rules.

In particular, clauses 6A.6.6(a) of the Rules require us to submit a forecast of total operating expenditure that we consider is required to meet the following operating expenditure objectives:

- to meet or manage the expected demand for prescribed transmission services over the forthcoming regulatory period;
- to comply with all applicable regulatory obligations or requirements associated with the provision of prescribed transmission services;
- maintain the quality, reliability and security of supply of prescribed transmission services and the reliability and security of the transmission system through the supply of prescribed transmission services[3]; and
- to maintain the safety of the transmission system through the supply of prescribed transmission services.

Our forecast must relate only to expenditure that is properly allocated to prescribed transmission services in accordance with our approved Cost Allocation Methodology.

We have adopted the AER's preferred 'base-step-trend' forecasting methodology and applied it in a manner that meets the operating expenditure objectives. The information presented in this attachment explains how we have applied this forecasting methodology and why the forecasts should therefore be accepted by the AER.

We confirm that our operating expenditure forecast relates only to expenditure that is properly allocated to prescribed transmission services in accordance with our approved Cost Allocation Methodology.[4]

This attachment is structured as follows:

- Section 6.3 explains the outcomes of our engagement with customers on the operating expenditure forecast.
- Section 6.4 presents an overview of our actual and expected operating expenditure in the current period alongside our forecast for the forthcoming regulatory period.
- Section 6.6 sets out our operating expenditure forecasting methodology.

[3] To the extent that there is no applicable regulatory obligation that must be met.

[4] We also confirm that none of our historical prescribed operating expenditure has been under arrangements that do not reflect arm's length terms. Further, none was incurred in transactions with related parties and that none fo the forecast relates to contingent projects.

- Section 6.7 describes the key inputs and assumptions underpinning our operating expenditure forecasts.
- Section 6.8 concludes by outlining the benefits and risks to customers that arise from our proposed operating expenditure program.
- Appendix A.1 explains our expenditure categories, as required by the Rules, and our actual and forecast operating expenditure for each of those categories.

6.3 The outcomes of our engagement with customers

In developing our expenditure plans we have engaged with our customers and wider stakeholders through our early engagement program to better understand their expectations and preferences.

As indicated in Table 6-1, our engagement process led to a detailed reconsideration of several issues relating to our operating expenditure forecasts and some important changes to our proposal. Further information is provided in the remainder of this attachment and in the Customer Engagement Outcomes Report[5].

Table 6-1: What we heard from customers and how we responded

What we heard	How we responded
ElectraNet should be doing everything to keep its costs as low as possible. What actions is ElectraNet taking to improve efficiency and drive down operating costs?	ElectraNet has stringent controls in place to manage its operating expenditure including restraints on recruitment, consultancy, travel, and training costs, in the face of growing external cost pressures which have required ElectraNet to overspend our allowance in the current period to meet our service obligations. This is not sustainable in the long term. We have finalised our operating expenditure forecasts considering the feedback received. Our final forecast represents a reduction of approximately $19m or 3% from our Preliminary Revenue Proposal. Our updated opex outlook is a realistic reflection of our expected costs; remains consistent with the AER's base step trend approach; satisfies the operating expenditure objectives of the Rules; and is reasonable for the purpose of establishing an efficient ex-ante opex allowance.
ElectraNet benchmarks poorly in opex terms based on AER benchmarking.	Overall productivity is what matters most to the total cost of service to customers. Despite the unique challenges of our network, ElectraNet has been the most efficient mainland TNSP when considered in total factor productivity terms since the AER's measures began in 2006. In response to the CAP's concerns, further information on our efficiency is provided in Section 6.4 below.

5 ElectraNet, *Customer Engagement Outcomes Report*, January 2022.

What we heard	How we responded
In relation to insurance ElectraNet should consider all options to balance the appropriate sharing of risk between customers, ElectraNet and others.	We agree risk should be shared appropriately between ElectraNet, customers and others including Governments. Given our legal obligations to maintain various levels of insurance cover, our practical ability to share risks is limited. Our final review of the insurance forecasts has resulted in a reduction of approximately $1m pa (or 14%) from the step change presented in our Preliminary Revenue Proposal.
The timing of expected legislative obligations related to cyber security remains uncertain and a cost pass-through may be more appropriate.	We have carefully considered this feedback in evaluating options available to the business. Our proposed expenditure for cyber security uplift reflects a full compliance solution based on the growing likelihood of firm legislative obligations in the short-term. Based on the feedback received, we will rely on a cost pass-through if cyber insurance becomes unavailable and we incur material costs because of a cyber incident.
A suitable productivity improvement factor should be considered, recognising the cost pressures being applied across businesses in the current COVID-19 environment.	We have applied a productivity factor to our operating expenditure forecast of 0.3% reflecting the average weighted productivity gain across transmission networks, consistent with the AER's benchmarking analysis and base step trend forecast methodology.
2020-21 is supported as a reasonable base year for the operating expenditure forecast.	We have continued to base our operating expenditure forecast on 2020-21 as a representative and efficient base year for the purposes of the opex forecast.

6.4 Efficiency benchmarking

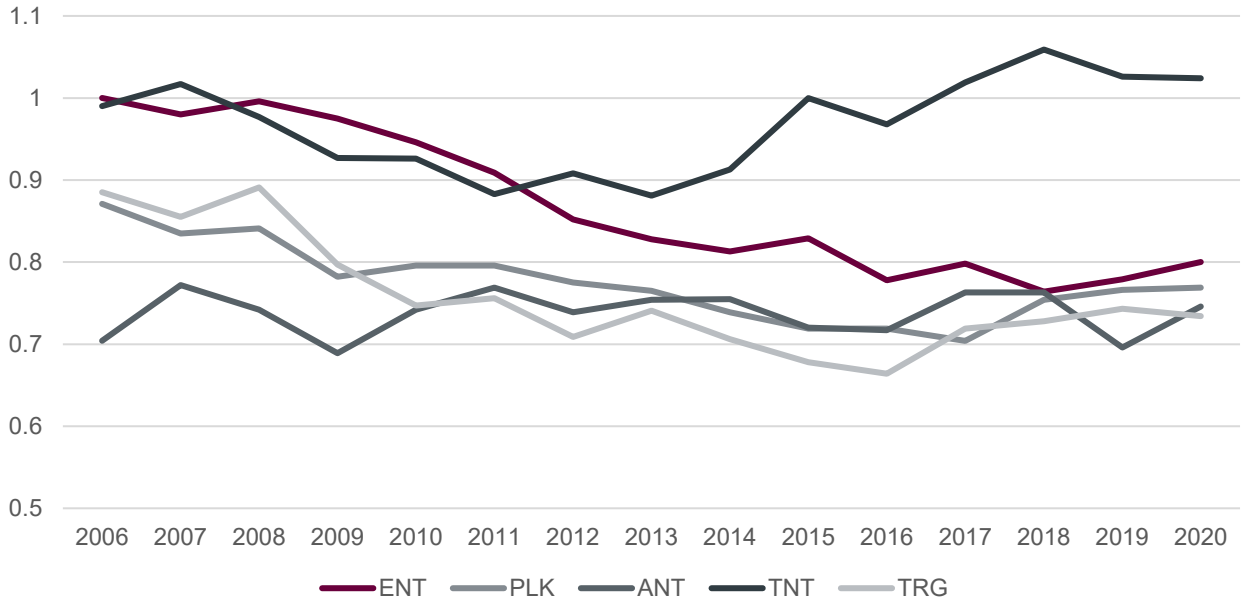
As explained in the previous section, our CAP highlighted the results of the AER's benchmarking report and asked us to consider its implications for our operating efficiency, and therefore the scope for future productivity improvements.

Figure 6-1 below reproduces Figure 4.1 from the AER's 2021 benchmarking report, which shows the Multilateral Total Factor Productivity (MTFP) index for each TNSP.[6]

This figure shows that we continue to perform well in overall productivity terms, consistently ranking second amongst the five TNSPs and the most efficient on the mainland.

[6] AER, Annual Benchmarking Report - Electricity Transmission Network Service Providers, November 2021, p20. The report is available at the AER's website: www.aer.gov.au

Figure 6-1: Multilateral total factor productivity index, 2006 to 2020

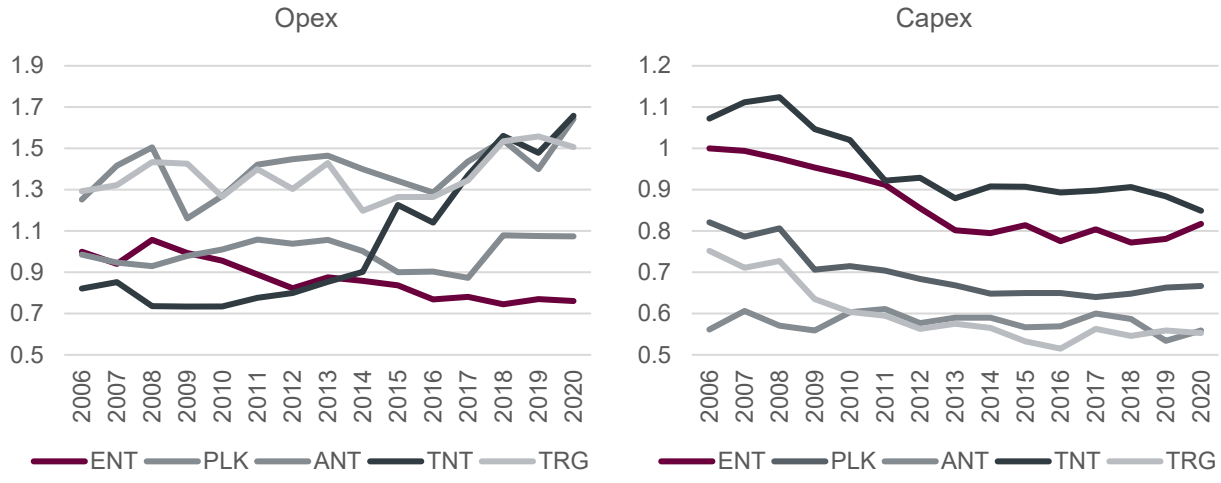


Source: AER

In addition to analysing MTFP, the AER's benchmarking report also assesses Multilateral Partial Factor Productivity (MPFP). The MPFP techniques use the same output specification as the MTFP technique, but focus only on the productivity of either operating expenditure or capital expenditure in isolation. Effectively, our overall efficiency is decomposed into operating and capital expenditure. This is why these benchmarks are referred to as 'partial' factor productivity measures.

Figure 6-2 below reproduces the AER's partial factor productivity measure for operating expenditure (left) and capex (right).[7]

Figure 6-2: Partial factor productivity indices, 2006 to 2020



7 AER, Annual Benchmarking Report - Electricity Transmission Network Service Providers, November 2021, p22.

While the partial factor productivity measure for operating expenditure shows that our performance is not as strong as our peers, this is to be expected given the age and composition of the network and the ongoing cost of maintaining it, coupled with the lack of scale economies available compared with other networks.

Despite these disadvantages, we maintain a strong ongoing focus on reducing our costs. We highlighted to our CAP specific examples of the measures we have taken to drive operating expenditure savings, including restrictions on recruitment, external consultancy, travel and training costs.

Partial factor productivity is also indicative of a different mix of operating and capital expenditure across the TNSPs. ElectraNet consistently ranks second in capex productivity terms and as the most efficient on the mainland as shown in the second pane above. This does not imply that we should attempt to make changes to that mix, or that this would lead to improved outcomes for customers. Most importantly for customers, our overall productivity provides confidence we are efficient relative to our peers.

It must also be remembered that transmission benchmarking has significant limitations, as the AER has consistently recognised. In future benchmarking reports, we expect these limitations to be further exposed as the analysis does not account for the growing role of transmission to provide system services, such as system strength services, which are not accounted for in the output measures chosen for the benchmarking analysis.

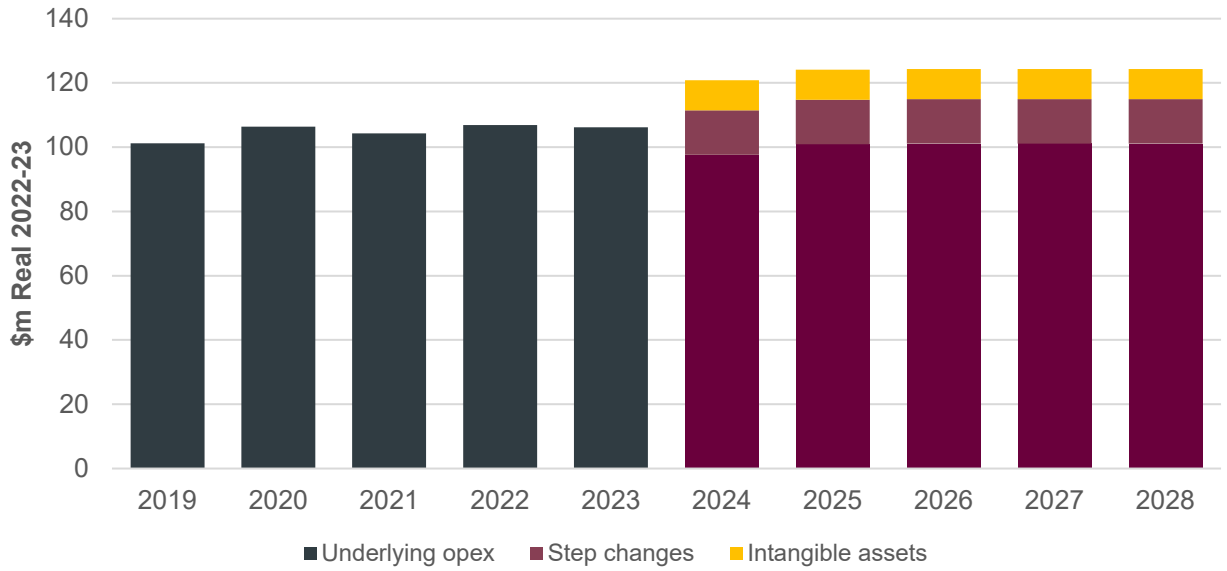
Our overall assessment is that there are no material further opportunities to sustainably reduce operating costs given known cost pressures, without jeopardising our ongoing ability to manage and operate the network to deliver the services customers expect.

In light of the efficiency initiatives already in place, our overall good benchmarking outcome when measured across operating and capital expenditure, and the fact that we are subject to an effective incentive regime that drives us to reveal our efficient costs, we consider that our current operating expenditure should be regarded as prudent and efficient.

6.5 Forecast operating expenditure

Figure 6-3 shows our forecast operating expenditure compared to our actual expenditure for the current period. It shows that underlying opex, in the darker colour, is forecast to be lower in the forthcoming regulatory period compared to the current period. This reflects the removal of the network support allowance used to ensure reliable supply in Port Lincoln and the Eyre Peninsula. This will no longer be required when the Eyre Peninsula Link is completed.

Figure 6-3: Actual and forecast total operating expenditure ($m 2022-23)



In the current period, we have continued to deliver efficiency improvements to put downward pressure on our operating expenditure, including:

- maintaining a targeted and cost-effective maintenance program through a reliability centred maintenance approach;
- reducing maintenance costs through improvement initiatives in procurement and delivery; and
- reducing corporate costs through restrictions on recruitment, travel, and training and reduced reliance on external consultants.

Notwithstanding these efforts, we have faced significant and sustained cost pressures during the current regulatory period that have driven our expenditure above the AER allowance, as the complexity of the network has increased.

In the forthcoming regulatory period, we have identified 'step changes' from external cost pressures that will drive operating expenditure increases, in addition to the impact of network growth, which will increase maintenance and operating costs.

Our operating expenditure forecast, derived using the base-step-trend method explained above, is summarised in Table 6-2 below.

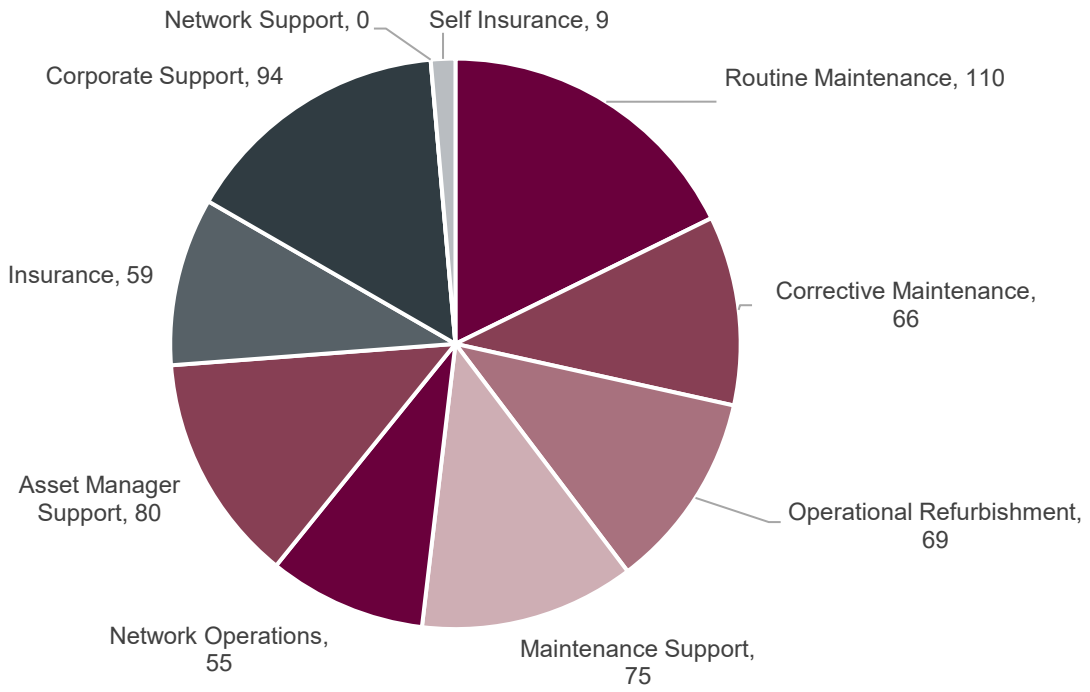
Table 6-2: Operating expenditure forecasts ($m 2022-23)

Element	Details in	2020-21	2023-24	2024-25	2025-26	2026-27	2027-28
Audited base year expenditure	Section 6.7.1	104.3					
Remove one off / non-recurrent items	Section 6.7.1	11.9					
Efficient base year costs	Section 6.7.1	92.4					
Rate of change	Section 6.7.2		2.5	5.7	5.9	6.0	5.9
Zero based forecasts (debt raising costs)	Section 6.7.4		1.7	1.7	1.7	1.7	1.7
Step changes	Section 6.7.3		13.8	13.8	13.8	13.8	13.8
Opex forecast (excl. intangible assets)			**113.2**	**116.5**	**116.7**	**116.7**	**116.7**
Intangible asset adjustment			9.4	9.4	9.4	9.4	9.4
Forecast operating expenditure (incl. intangible assets)			**122.6**	**125.8**	**126.0**	**126.1**	**126.0**

Our total forecast operating expenditure for the forthcoming regulatory period is $627m in 2022-23 dollars including intangible assets and debt raising costs.

Our operating expenditure forecasts by category are presented in Figure 6-4 below.

Figure 6-4: Total operating expenditure 2023-24 to 2027-28 by category ($m 2022-23)[a]



[a]the values shown are inclusive of intangible assets.

Table 6-3: Operating expenditure: current and forecast regulatory period by category ($m 2022-23)[a]

	2018-19A	2019-20A	2020-21A	2021-22F	2022-23F	2023-24F	2024-25F	2025-26F	2026-27F	2027-28F
Routine Maintenance	20.12	19.24	20.25	19.89	20.99	21.32	22.03	22.07	22.08	22.07
Corrective Maintenance	11.62	11.11	12.32	11.99	12.77	12.90	13.34	13.36	13.36	13.36
Operational Refurbishment	12.77	12.21	12.87	13.89	13.34	13.48	13.94	13.96	13.96	13.96
Maintenance Support	13.16	13.22	13.44	14.55	13.94	14.67	15.14	15.17	15.17	15.17
Network Operations	11.74	11.74	10.26	11.98	10.64	10.75	11.11	11.13	11.14	11.13
Asset Manager Support	10.22	11.35	10.20	11.45	10.58	15.74	16.10	16.12	16.12	16.12
Corporate Support	7.80	10.69	6.98	3.34	7.23	18.68	18.93	18.94	18.95	18.94
Insurance	3.06	3.99	5.31	6.58	5.51	11.61	11.80	11.81	11.81	11.81
Self Insurance	1.59	1.60	1.59	1.64	1.65	1.67	1.72	1.73	1.73	1.73
Network Support	9.10	11.21	11.07	11.61	9.57	0.00	0.00	0.00	0.00	0.00
Debt raising costs	1.39	1.40	1.46	1.50	1.67	1.75	1.75	1.75	1.75	1.74
TOTAL	**102.56**	**107.76**	**105.75**	**108.42**	**107.87**	**122.57**	**125.86**	**126.04**	**126.06**	**126.02**

[a]the values in this table are inclusive of intangible assets.

Further detail of the way the forecast is expected to be spent is provided in Table 6-4. A more detailed description of the operating expenditure categories is provided in Appendix A.

Table 6-4: Operating expenditure categories ($m 2022-23)

Category	Opex forecast (pre intangible assets	Intangible asset adjustment	Opex forecast (post intangible assets	Description
Routine Maintenance	110		110	This involves maintenance tasks and activities undertaken on a scheduled basis including asset testing, inspections, line patrols, vegetation clearance.
Corrective Maintenance	66		66	This work involves short-term responses to unplanned events to restore assets to an operational state. Examples include mechanical breakdown, storm damage and other weather events, equipment malfunction and deterioration.
Operational Refurbishment	69		69	This includes maintenance project activities to address medium-term risks typically identified though asset condition assessments.
Maintenance Support	72	3	75	Functions include management of maintenance activity, environmental and safety management, asset-condition monitoring, supporting business systems and direct charges including land taxes and council rates.
Network Operations	55		55	Includes real-time control-room functions, offline support, maintenance of operational control systems, monitoring of asset performance and condition and fault diagnosis.
Asset Manager Support	59	21	80	The functional activities that support the strategic development and ongoing management of the network. Includes network planning, asset strategy, network support, customer and regulatory support and IT support.
Corporate Support	94		94	The cost of purchasing insurance
Insurance	37	22	59	Activities required to ensure adequate and effective corporate governance and business administration, including finance, accounting, administration, legal counsel, employee relations, occupational health and safety and internal audit.

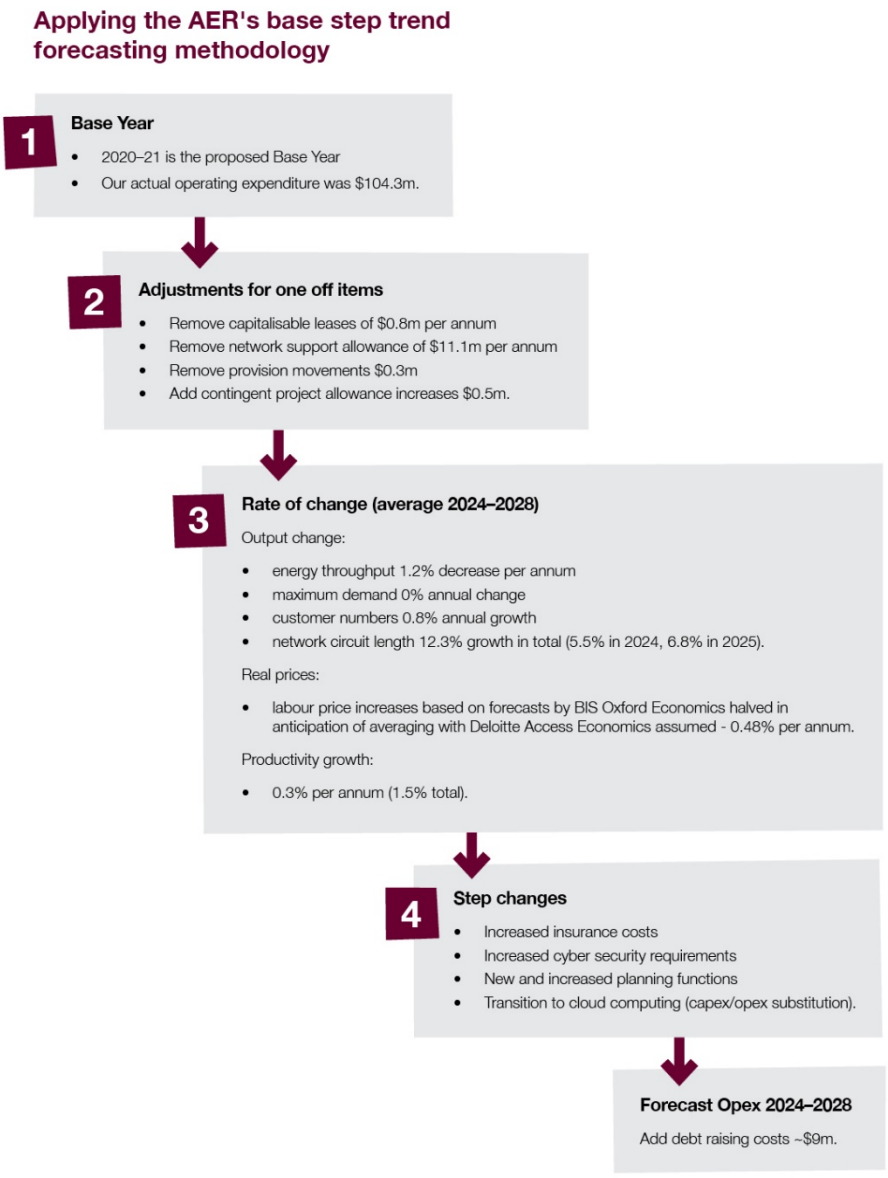
Category	Opex forecast (pre intangible assets	Intangible asset adjustment	Opex forecast (post intangible assets	Description
Network Support	0		0	Network support payments fund non-network solutions contracted by us as cost effective alternatives to network augmentation, such as local generation or demand management arrangements. While none of these services are forecast now, they could be required in future.
Self Insurance	9		9	Where external insurance cover is not available or not cost effective for certain risk events, we manage the risk exposure and cost impact of these events internally through self-insurance
Total	572	46	618	

Approximately 74% of ElectraNet's annual operating expenditure (inclusive of intangible assets) is associated with maintenance and operation of the network through our maintenance programs and network operations functions (76% if the effect of intangible asset accounting rules is disregarded).

6.6 Forecasting methodology

In preparing our operating expenditure forecast, we have applied the 'base-step-trend' method set out in the AER's Expenditure Forecast Assessment Guideline[8], as shown below.

Figure 6-5: Applying the AERs base step-trend forecasting methodology



[8] *Better Regulation: Expenditure Forecast Assessment Guideline for Electricity Transmission*, Australian Energy Regulator, November 2013 available at http://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/expenditure-forecast-assessment-guideline-2013.

Following our pre-lodgement discussions with the AER, we modified our application of the methodology by treating external shocks to the cost of insurance as a step change rather than a category specific forecast. In this Revenue Proposal, only debt raising costs have been included in our forecast operating expenditure on a bottom up basis.

Our forecasting approach in relation to each expenditure category is fully aligned with the AER's preferred application of its base-step-trend methodology.

6.7 Key inputs and assumptions

The key inputs and assumptions used to derive our trend operating expenditure forecast are outlined below, followed by an explanation of our step changes in the following sections.

6.7.1 Establishing the recurrent base year cost

The 2020–21 regulatory year is the base year for determining the recurrent component of our operating expenditure forecast. We have chosen 2020-21 as our base year for operating expenditure forecasting because:

- it is the most recent full regulatory year of actual reported and audited operating expenditure at the time of preparing this Revenue Proposal;
- it is representative of our operating conditions for the current and forthcoming regulatory periods;
- it incorporates the efficiency gains that we have achieved to date; and
- its selection is consistent with the design of the Efficiency Benefit Sharing Scheme.

In accordance with the methodology outlined in Section 6.6, we have deducted the following one-off or non-recurrent expenditure items so that the base year reflects our expected ongoing expenditure:

- Network support allowance
- Capitalisable leases
- the movement in provisions in our base year operating expenditure.

Table 6-5 below shows the derivation of our efficient base year operating expenditure.

Table 6-5: Efficient base year operating expenditure ($m 2022-23)

Item	Amount
Audited operating expenditure for 2020–21	**104.3**
Deduct non-recurrent / one-off items	-11.6
Remove movement in provisions	-0.3
Base year efficient operating expenditure	**92.4**

Before proceeding to the next step of the forecasting methodology, we must first verify that the base year operating expenditure is efficient. This verification provides confidence that the resulting operating expenditure forecasts, which build from the base year, reasonably reflect efficient costs.[9]

The first point to note is that expenditure in the base year was lower than the years around it as shown in Figure 6-3 above.

The second point to note is the AER's following observation in its Expenditure Forecast Guideline (emphasis added):[10]

> *"For recurrent expenditure, we prefer to use revealed (past actual) costs as the starting point for assessing and determining efficient forecasts.* ***If a TNSP operated under an effective incentive framework, actual past expenditure should be a good indicator of the efficient expenditure the NSP requires in the future.*** *The ex-ante incentive regime provides an incentive to improve efficiency (that is, by spending less than the AER's allowance) because TNSPs can retain a portion of cost savings made during the regulatory control period. However, the incentive to spend less than our allowance must not be to the detriment of the quality of the services the TNSP supplies."*

We agree with the AER's comments. As a private, commercially driven business, ElectraNet has responded to the incentive framework since its inception and has delivered substantial efficiency improvements over time notwithstanding our measured opex productivity as discussed above. While our actual costs in 2020-21 exceeded the AER's allowance for that year, the adverse outcome was driven by a number of factors outside our control, including the impact of substantially increased insurance costs.

6.7.2 Applying rate of change

The efficient base year is projected forward by applying a real rate of change, following the AER's Guideline approach. The real rate of change is a function of the forecast change in: output, real price (i.e. labour and material input costs) and productivity, as follows.

$$\textbf{Rate of change} = \textbf{Output change} + \textbf{Real Price Change} - \textbf{Productivity Change}$$

The following sections explain the values adopted for each of these 'rate of change' components to develop our forecasts in turn.

6.7.2.1 Output change

For the forthcoming regulatory period, output change is calculated based on the weighted average of the output measures, as follows:

- **Energy throughput** The forecast growth in energy delivered for the South Australian network plus net imports.
- **Ratcheted maximum demand** Non-coincident historic maximum demand for each individual connection point in a year measured in MW.
- **Circuit length** Total transmission line circuit length measured in kilometres.
- **End user numbers** Total number of distribution connected customers.

We have adopted the weightings for these measures from the AER's 2021 Annual Benchmarking Report, which is the latest available data.

[9] In accordance with clause 6A.6.6(c)(1) of the Rules.
[10] AER, Expenditure Forecast Assessment Guideline for Electricity Transmission, November 2013, p9 and p10.

Our proposed output growth for the purposes of forecasting our operating expenditure, which has been calculated in accordance with the AER's methodology, is presented in the table below.

Table 6-6: Output growth factors (%)

	2023-24	2024-25	2025-26	2026-27	2027-28	Average 2024-28
Energy throughput	-2.6%	-2.7%	-0.3%	-0.2%	-0.1%	-1.2%
Ratcheted maximum demand	0%	0%	0%	0%	0%	0%
Circuit length	5.5%	6.8%	0.0%	0.0%	0.0%	2.5%
End user numbers	0.8%	0.8%	0.9%	0.9%	0.9%	0.8%
Total output growth	2.6%	2.6%	2.6%	2.6%	2.6%	2.6%

6.7.2.2 Real price change

Cost escalation involves adjusting estimates for expected changes in input costs, being wages, contractor rates and materials. Forecasts of cost escalation rates are derived from independent expert sources.

In recent revenue determinations, the AER has included an allowance for real price changes in the operating expenditure forecasts, comprising:

- Labour price escalation calculated as the average of forecasts prepared by BIS Oxford Economics, on behalf of the relevant network business, and Deloitte Access Economics, on behalf of the AER; and
- Material cost escalation of zero, an assumption that material costs will change in in line with CPI.

Consistent with this methodology, as explained in Section 5.7.7 of Attachment 5 in relation to the capital expenditure forecast, our proposed labour and materials escalators for the purposes of the operating expenditure forecast are set out in Table 6-7 and Table 6-8 below.[11]

Table 6-7: Real labour cost escalation forecast (%)

	2023-24	2024-25	2025-26	2026-27	2027-28	Average 2024-28
BIS OE forecast (inc SGC)	0.90%	1.20%	1.30%	0.80%	0.60%	0.96%
Halved	0.45%	0.60%	0.65%	0.40%	0.30%	0.48%

[11] We also provide a copy of our current Enterprise Bargaining Agreement in response to the Reset Regulatory Information Notice though we note that it expires during the current period so does not affect the forecasts presented here.

Table 6-8: Real labour and material cost forecast (%)

	2023-24	2024-25	2025-26	2026-27	2027-28	Average 2024-28
Labour	0.45%	0.60%	0.65%	0.40%	0.30%	0.48%
Materials	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Weighted Average	0.32%	0.42%	0.46%	0.28%	0.21%	0.34%

6.7.2.3 Productivity change

We note that the AER adopted a productivity improvement of 0.3% per annum in its recent draft decisions for Powerlink and AusNet Services based on its latest available benchmark reports. The AER's estimate reflects the trend annual productivity growth rate for the period 2006-2020, by taking a line of best fit through all the data points. We note that AusNet Services accepted the AER's draft decision.

As noted in section 6.3, we discussed the issue of future productivity improvements with the CAP Working Group, which expressed concern that the AER's benchmarking indicates that our operating expenditure performance does not compare favourably with our peers. As explained in Section 6.4, our view is that our operating expenditure is efficient and does not support a higher future productivity improvement than our peers.

Our approach, therefore, is to adopt a 0.3% per annum efficiency, which is consistent with the AER's approach in its most recent decisions for Powerlink and AusNet Services.

Table 6-9: Forecast productivity improvement (%)

	2023-24	2024-25	2025-26	2026-27	2027-28	Average 2024-28
Productivity savings	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%

6.7.3 Step changes

In relation to step changes, we are proposing to include costs relating to:

- **Insurance**. Since 2018 the global insurance market has experienced significant volatility, with ongoing premium increases and a contraction in available insurance cover capacity. This ongoing market volatility continues to drive substantial increases in our insurance premiums. We have obtained an independent expert report from Marsh to estimate our insurance costs for the forthcoming regulatory period. The step change is the difference between the insurance costs in our base year, and the cost forecasts prepared by Marsh.[12]
- **Cyber security**. New Critical Infrastructure legislation to implement the Australian Energy Sector Cyber Security Framework is expected to require additional expenditure during the forthcoming regulatory period. We have included a step change allowance based on our best estimates of the additional cost we will incur in reaching Security Profile 3 under that framework.

[12] This forecast excludes the impact of the most recent insurance claim events, on which full information was not available at the time of lodgement. The impacts of these events and annual insurance renewal outcomes in 2022, will be considered and any required changes or updates to the insurance forecasts will be made when the relevant information is available.

- **Migration to the Cloud**. We have identified a requirement to migrate part of our IT infrastructure to the Cloud in order to maintain and enhance operational capabilities moving forward. Migration to the Cloud involves a capex/opex trade off, which is appropriately addressed through a step change to cover the cost of additional licence fees, which is more than offset by capital cost savings and other benefits.
- **Recent rule changes**. Recent rule changes will give us additional responsibilities in planning and managing an increasingly complex electricity network, requiring additional specialist resources. We have included a step change amount that reflects our best estimate of the operating costs arising from these Rule changes, as set out below:
  - Renewable Energy Zone (REZ) Planning Rules (13 May 2021) - Obligations for planning the staged development of REZs identified in AEMO's Integrated System Plan (ISP) (recurrent costs only).[13]
  - General Power System Risk Review Rules (3 June 2021) - Comprehensive annual review to be undertaken by AEMO requiring additional input, analysis and information from TNSPs including additional modelling capability at an upfront cost of $1m.
  - Connection to Dedicated Connection Assets Rule (8 July 2021) - Additional information publication and prescribed service obligations.
  - Efficient Management of System Strength Rule (21 October 2021) - New obligations for forward looking planning for and provision of system strength services by TNSPs, subject to detailed RIT-T assessment.

In total these step changes will add approximately 13% to our total operating expenditure over the next 5 years.

Table 6-10: Step changes ($m 2022-23)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Insurance	6.0	6.0	6.0	6.0	6.0	30.2
Cyber Security	5.2	5.2	5.2	5.2	5.2	25.9
Migration to Cloud	1.8	1.8	1.8	1.8	1.8	9.0
Recent Rule changes	0.8	0.8	0.8	0.8	0.8	3.9
Total	**13.8**	**13.8**	**13.8**	**13.8**	**13.8**	**69.1**

6.7.4 Zero based ('bottom up') expenditure items

As noted in Section 6.6, we develop a bottom-up forecast in relation to debt raising costs. The basis of this forecast is explained below. We also comment on network support and AEMO Participant Fees, which may also be forecast on a bottom up basis if circumstances change.

6.7.4.1 Debt raising

Debt raising costs are benchmarked costs associated with raising or refinancing debt. These costs include underwriting fees, legal fees, company credit rating fees and other transaction costs. Debt

[13] As discussed further in Attachments 5 and 12, these ongoing costs are distinct from the cost of preparing REZ design reports we may be asked to prepare in future and the capital cost of constructing any REZ that ultimately proceeds.

raising costs are an unavoidable aspect of raising debt that would be incurred by any large company.

An allowance for these costs has been determined by applying the standard benchmark methodology approved by the AER, as reflected in the AER's Post Tax Revenue Model (PTRM).

Table 6-11 below sets out our proposed debt raising cost allowance.

Table 6-11: Forecast debt raising costs ($m 2022-23)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Debt raising	1.7	1.7	1.7	1.7	1.7	**8.7**

6.7.4.2 Network Support

Our current operating expenditure includes a network support allowance of approximately $11.1 million in 2020-21. As already noted, we have removed this amount from our base year operating expenditure because the completion of the Eyre Peninsula Link will mean that this network support service will no longer be required.

Looking forward, we are currently working to respond to a shortfall in Fast Frequency Response services in South Australia declared by AEMO. This could potentially result in additional service costs being passed to customers in the coming regulatory period.

Should this be confirmed in the coming months we will endeavour to reflect these costs as necessary in our Revised Revenue Proposal, for example as a Network Support allowance.

In the meantime, our current forecast network support allowance is as shown in Table 6-12.

Table 6-12: Forecast network support allowance ($m 2022-23)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Network Support	0	0	0	0	0	0

6.7.4.3 AEMO Participant Fees

A Rule change has been submitted seeking to clarify the ability of TNSPs to recover new AEMO Participant Fees in addition to the Maximum Allowed Revenue of each TNSP. While these costs are properly considered as a revenue recovery item, should this Rule change be unsuccessful or delayed for any reason, it may become necessary to include an additional operating expenditure allowance to cover the estimated costs of AEMO's Participant Fees payable by ElectraNet to ensure the ability to recover these costs. At this stage, no allowance has been included in our operating expenditure forecasts.

6.8 Benefits and risks for customers

As explained in our Revenue Proposal Overview, the principal benefits to customers from our Revenue Proposal are reflected in our asset management objectives:

- **Safety of people** - ensure the safety of staff, contractors, and the public;
- **Affordability and reliability** - reduce the overall cost of electricity to customers by removing network constraints, operating the network, and delivering our capital and maintenance works as efficiently as possible, while maintaining safety and reliability.
- **Power system security and resilience** - ensure the network is resilient and operates within acceptable parameters in the face of electrical, physical, or cyber disruption, and continues to enable the transition to a low carbon emissions future.
- **Protect the environment** - ensure the environmental impact of network operations are minimised.

More specifically in relation to our operating expenditure program, customers can expect the following benefits:

- Efficiency – We will continue to drive improvements in our operating cost performance, despite the external cost increases that are being driven by factors that are outside our control.
- Affordability – Our underlying operating expenditure, excluding step changes, will fall by 4% over the forthcoming regulatory period.
- Choice – Our operating expenditure program will continue to manage the challenges of an increasingly complex power system to support the differing choices being made by customers over the way energy will be produced and consumed in the future.
- Long term sustainability – We are continuing to manage and maintain the transmission network to accommodate the changing nature of generation and demand as we move to a low carbon economy, and to deliver the outcomes sought by customers into the future.

We are aiming to manage the following risks to customers through our operating expenditure program:

- New obligations – we have identified new obligations that are being addressed through the inclusion of step changes in our forecast operating expenditure. In addition to these known obligations, it is possible that further obligations may be imposed during the forthcoming regulatory period that lead to a cost pass through application.
- Nominated pass through events – we have proposed the following cost ‘pass through events’ to most efficiently manage the risk to customers of rare and extreme events outside our control that could lead to higher costs for customers if one or more of these events occurred, rather than include such amounts in our forecasts:
  - Terrorism event;
  - Natural disaster event;
  - Insurer credit risk event;
  - Insurance coverage event;
  - System strength services event; and
  - REZ design report event.

- A detailed explanation of our proposed pass through events is provided in Attachment 13, noting that the first four pass through provisions are substantially unchanged from the current regulatory period.
- Our plans are based on the best available information at the time of submission in relation to our operating expenditure requirements for the forthcoming regulatory period. However, there remains a possibility that new information may come to light following further internal analysis and external reviews and investigations that results in a need for additional unforeseen operating expenditure. Any such information will be provided as it becomes available, either prior to or within a Revised Revenue Proposal.

Appendix A : Appendix A Operating expenditure categories

A.1 Operating expenditure categories and services

Schedule S6A.1.2(1) of the Rules requires that our operating expenditure forecasts are presented by reference to well accepted categories and the services that relate to those categories. The purpose of this section is to address those Rule requirements. Our expenditure categories are set out in Figure 6-6.

Figure 6-6: Operating expenditure categories

Table 6-13 describes our operating expenditure categories in detail.

Table 6-13: Description of operating expenditure categories

Expenditure Category	Description	Service Category
Controllable Operating Expenditure - Direct Operating & Maintenance		
Field Maintenance	Includes all field-based maintenance activities: Routine maintenance - field inspections and maintenance activities that are completed to a predetermined schedule and scope; Corrective maintenance - field activities to mitigate short term risks and restore the condition or function of a transmission system asset, or component, to a satisfactory operational state; and Operational refurbishment - planned maintenance project activities to mitigate medium term risks identified through asset condition assessments and to provide asset information required to manage compliance with legal obligations and good electricity industry practice.	Prescribed Exit Services, Prescribed Entry Services, Transmission Use of System Services (TUOS) & Common Services
Maintenance Support	Includes all of our internal functions associated with managing field operating and maintenance contracts, environmental and safety management, asset condition monitoring and analysis, works planning and coordination. Maintenance support also includes functions associated with business processes and systems that directly support the field maintenance activities such as geospatial information systems, maintenance management systems and maintenance field tools, and the activities associated with the management and support of external maintenance service contracts and direct charges such as land taxes, water and council rates.	Prescribed Exit Services, Prescribed Entry Services, TUOS & Common Services
Network Operations	These are activities associated with the control of the network and other network operations activities. The functions in this category include: • Real-time (24-hour) control room function – this is a 24-hour continuous requirement. Network operators provide the functions of network operation, coordination and switching sheet preparation for all plant outages • Off-line system security support – this function involves network security analysis, including an ongoing need to perform contingency planning • Technical support for the Energy Management System (EMS) and SCADA systems – support functions such as EMS configuration, upgrade, hardware installation, software upgrade and maintenance; and • Asset Monitoring – Monitoring asset performance and condition, which includes auditing network configurations and performing fault diagnosis and response management.	Prescribed Exit Services, Prescribed Entry Services, TUOS & Common Services

Expenditure Category	Description	Service Category
Other Controllable Expenditure		
Asset Manager Support	Includes the functional activities that support the strategic development and ongoing management of the network, including network planning, asset strategy, network support, customer and regulatory support and IT support.	Prescribed Exit Services, Prescribed Entry Services, TUOS & Common Services
Corporate Support	• Includes the activities required to ensure adequate and effective corporate governance and business administration, including finance, accounting, administration, legal counsel, employee relations, occupational health and safety and internal audit. • Corporate Support also includes insurance premiums and the associated costs of commercially available insurance cover obtained from external sources by ElectraNet for its assets and other key risk exposures (excluding self-insurance).	Prescribed Exit Services, Prescribed Entry Services, TUOS & Common Services
Non-controllable Operating Expenditure		
Self Insurance	Where external insurance cover is not available or not cost effective for certain risk events, ElectraNet manages the risk exposure and cost impact of these events internally through a self-insurance allowance based on identification and quantification of the asymmetric risks faced by the business.	Prescribed Exit Services, Prescribed Entry Services, TUOS & Common Services
Debt Raising	Includes debt financing and transaction costs incurred over and above the debt margin allowed in the cost of capital when new debt is raised or current lines of credit are refinanced or extended.	Prescribed Exit Services, Prescribed Entry Services, TUOS & Common Services

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