5 November 2020

Mr Sebastian Roberts
General Manager
Transmission and Gas
Australian Energy Regulator

Via email: sebastian.roberts@aer.gov.au

Dear Sebastian

re: Framework and Approach – ElectraNet 2023-2028 Regulatory Determination

The purpose of this letter is to provide initial input to the AER's framework and approach paper in relation to ElectraNet's upcoming revenue determination for the regulatory period of 1 July 2023 to 30 June 2028. The Rules require the AER to publish its framework and approach paper by 31 July 2021.

The following comments address each element of the framework and approach paper in turn and outline the basis on which each of the guidelines and requirements is proposed to apply.

Service Target Performance Incentive Scheme (STPIS)

The STPIS provides a financial incentive to maintain and improve network performance based on a number of separate components. It is expected that the prevailing version of the STPIS (version 5 corrected) will be applied to ElectraNet.

On 3 February 2020, Energy Network Australia wrote to you on behalf of transmission businesses expressing concerns over the setting of performance targets for the Market Impact Component (MIC) of the scheme. Specifically, the fundamental changes occurring in the power system are materially increasing the level of network constraints. Consequently, the use of historical performance for target setting is not expected to reflect possible future outcomes, potentially leaving network businesses in a position where performance targets are no longer achievable. This would remove any incentive to improve performance for the benefit of customers under this component of the scheme.

You have responded to network businesses indicating that while the AER sees no immediate need for a review of the MIC, the AER expects that a review of the operation and interactions between the major incentive schemes and nature of the STPIS will be necessary in the near future.

More broadly, as you are also aware, potential reforms to elements of the STPIS as it applies to transmission businesses are also being considered in the context of the AEMC's COGATI Review and System Strength Investigation and in the Energy Security Board's NEM 2025 Review.

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ElectraNet looks forward to engaging in any such review of the STPIS to address these issues and would expect that any revised scheme would apply to ElectraNet moving forward.

At this stage, ElectraNet does not propose any variations to the remaining elements of the scheme.

Operating Expenditure Efficiency Benefit Sharing Scheme (EBSS)

The EBSS aims to provide an incentive for ongoing efficiency improvements in operating expenditure. It is expected that the prevailing version of the EBSS (version 2) will be applied to ElectraNet.

The new ISP Rules introduce obligations on transmission businesses to progress early works in relation to actionable ISP projects identified by AEMO. If such projects do not proceed to full regulatory approval, the expenditure incurred will likely need to be written-off as an operational expense. While the manner in which this would be recovered has yet to be fully settled, for the avoidance of doubt any such write off amounts should be excluded from the operation of the EBSS to the extent these lie outside the approved operating expenditure allowance.

Equally, the current proposals for the development and implementation of Renewable Energy Zones (REZs) would impose significant new obligations on network businesses for the planning and staged development of REZs. Again, while the manner in which the costs of this additional planning work would be recovered has yet to be fully settled, for the avoidance of doubt any such amounts should be excluded from the operation of the EBSS to the extent these lie outside the approved operating expenditure allowance.

ElectraNet would be pleased to engage further with the AER in relation to these issues.

Capital Expenditure Sharing Scheme (CESS)

The CESS aims to provide an incentive for efficiency improvements in capital expenditure and provides for ex post reviews of any over-spends of the capital expenditure allowance. It is expected that the prevailing version of the CESS (version 1) will be applied to ElectraNet.

As separately raised with the AER in the context of current contingent project applications, an unintended interaction has been identified between the provisions of the Rules which apply to contingent projects which span regulatory periods and the operation of the CESS.

Specifically, the Rules require that the total approved capital expenditure allowance of a contingent project should be preserved. Therefore, if the approved allowance for the project is exceeded in the first regulatory period, a corresponding reduction is applied to the balance of the approved allowance in the following regulatory period. In addition, the CESS will impose a penalty in relation to any overspend relative to the allowance in the first period, to be applied in following period.

This results in a double penalty for any overspend, imposing a disproportionate impact on the network business. The converse also applies, whereby a double benefit would apply for any underspend experienced in the first regulatory period, imposing a disproportionate impact on network customers.

For these reasons, ElectraNet proposes that the CESS would not apply to any approved contingent project approved in the coming regulatory period that spans multiple regulatory periods to avoid this unintended consequence for customers and ElectraNet under the CESS.

Small Scale Incentive Scheme

The Rules allow for the AER to develop a small-scale incentive scheme applicable to TNSPs. This allows the AER to test innovative approaches to incentives to encourage further improvements in the delivery of network services for the long-term benefit of electricity consumers, in a manner that complements the existing incentive arrangements in place.

ElectraNet notes that the AER has not chosen to develop such an incentive scheme to date, and therefore no such scheme would presently apply for the purposes of ElectraNet's forthcoming regulatory control period.

However, should the AER determine such a scheme to apply, ElectraNet would be pleased to discuss the potential merits and basis of such a scheme in the long-term interests of customers.

Expenditure Forecast Assessment Guideline

The Expenditure Forecast Assessment Guideline establishes the basis on which the AER will assess capital and operating expenditure forecasts, including associated information requirements. It is expected that the Guideline as currently in force will apply to ElectraNet.

ElectraNet accepts the continued application of the prevailing guidelines and assessment techniques, while noting that clear limitations exist with the current AER TNSP benchmarking methodology including the extent to which this information can meaningfully be applied in the assessment of expenditure across transmission businesses, as we have raised over the years. ElectraNet looks forward to further engaging with the AER in relation to relevant comparators of performance reflecting the specific challenges and circumstances facing South Australia's transmission network.

Basis of Depreciation

The Rules allow the AER to determine whether the depreciation applied in establishing the Regulatory Asset Base at the end of the control period should be based on forecast or actual capital expenditure. The AER's approach has generally been to apply forecast depreciation, unless circumstances warrant departing from this approach. At this stage ElectraNet is not seeking to depart from this approach for the next regulatory control period.

ElectraNet has recently submitted a Rule change to support the financeabilty of actionable ISP projects which would result in changes to the indexation of the Regulated Asset Base (RAB) and the calculation of the depreciation allowance for Project EnergyConnect and any other future ISP projects. This would require a separate Post Tax Revenue Model (PTRM) and Roll Forward Model (RFM) to be established by the AER for this purpose. ElectraNet looks forward to working with the AER on the implementation of this Rule change, if approved by the AEMC.

Demand Management Innovation Allowance Mechanism (DMIAM)

The AER is currently developing a DMIAM for TNSPs. Following recent amendments to the Rules, the purpose of this mechanism is to provide TNSPs with funding for research and development in demand management projects that have the potential to reduce long-term network costs. Appropriately applied, the mechanism will deliver long-term benefit to customers through better management of energy demand.

As input to its initial consultation ElectraNet has shared with the AER information on the types of initiatives that may fall within the scope of the DMIAM for transmission, noting that ElectraNet faces a particular challenge in managing rapidly declining minimum (and negative) demand levels on the South Australian transmission network.

These potential measures include the use of demand side response to support emergency management schemes, smooth regional demand, manage intermittent generation output fluctuations, reduce negative power flows and support integration of electric vehicles into the grid.

We look forward to further engaging with the AER in the development of the mechanism and expect that it would be introduced in time to apply to ElectraNet for the forthcoming regulatory control period to enable these benefits to be realised for customers.

ElectraNet appreciates the opportunity to provide the above input for the purpose of initiating the AER's framework and approach process for the forthcoming Revenue Determination for 2023-2028.

ElectraNet would be pleased to discuss any aspects further and looks forward to the opportunity to respond to any issues raised in the development and consultation on the proposed framework and approach, or new information which may arise.

Should you have any queries or require additional information, please do not hesitate to contact me on [redacted] to discuss any aspects of this letter.

Yours sincerely

Simon Appleby
Manager Regulation and Investment Planning