Major Energy Users Inc.

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TransGrid and ElectraNet
Project EnergyConnect
Contingent Project Applications

Major Energy Users Inc (MEU) is pleased for the opportunity to provide its views on the contingent project applications made by TransGrid and ElectraNet in relation to Project EnergyConnect (PEC) – a new interconnector between SA and NSW. The MEU considers that the AER needs to investigate the project more fully and get formal stakeholder input into whether the project does deliver the net benefits claimed.

The MEU was established by very large energy using firms to represent their interests in the energy markets. With regard to all of the energy supplies they need to continue their operations and so supply to their customers, MEU members are vitally interested in four key aspects – the cost of the energy supplies, the reliability of delivery for those supplies, the quality of the delivered supplies and the long term security for the continuation of those supplies.

Many of the MEU members, being regionally based, are heavily dependent on local staff, suppliers of hardware and services, and have an obligation to represent the views of these local suppliers. With this in mind, the members of the MEU require their views to not only represent the views of large energy users, but also those interests of smaller power and gas users, and even at the residences used by their workforces that live in the regions where the members operate.

It is on this basis the MEU and its regional affiliates have been advocating in the interests of energy consumers for over 20 years and it has a high recognition as providing informed comment on energy issues from a consumer viewpoint with various regulators (ACCC, AEMO, AEMC, AER and regional regulators) and with governments.

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Through its involvement in ElectraNet's Consumer Advisory Panel, the MEU has been an active participant in the development of the new proposed interconnector between the SA region and the NSW region. The MEU accepts that the interconnector will provide benefits to consumers in both regions and, based on the assessments of the various options, would appear to be the optimal approach to serving the needs of consumers.

Despite being supportive in principle of the proposal, the MEU has a number of concerns about the latest information used to justify the project delivering long term benefits to consumers, sufficient to offset the current high cost of the project.

The MEU has reviewed the ElectraNet report – Project EnergyConnect Updated Cost Benefit Analysis dated 30 September 2020 – and is very concerned that the capital cost of the projects has nominally increased by 60% since the project was initially accepted by the AER under the RIT-T process. To offset this increase in capital cost, the proponents (TransGrid and ElectraNet) have provided a view that the benefits of the project have risen by 50% above their initial estimates. The proponents advise that, despite the increased capital cost and increased benefits assessed, as the project continues to deliver a net benefit there is no material change and therefore a formal reassessment of the project financials under the RIT-T process is not necessary. It appears that the AER has agreed that this assertion by the proponents is acceptable.

While the MEU understands that the AER has reviewed the new capital costs and the revised (increased) forecast benefits, the MEU is very concerned that the AER has not sought wider stakeholder input into assessing the viability of the project, or tested if there is widespread acceptance the project is still efficient and will deliver benefits in the long term interests of consumers.

Overall, the MEU notes the project requires a capital injection of about $2.5 Bn to deliver a net benefit (on the central case) to consumers of about $150 M[1] – and considers this a very low return for such a massive cost when assessed on a risk/reward basis.

The MEU is also aware that the PEC proponents have sought a rule change to be applied to the PEC project (and other ISP projects they might undertake) which would change the regulatory approach to assessing projects in two significant details:

1. That the project revenue stream be converted from a depreciated replacement cost RAB times real WACC basis (the current regulatory approach) to a depreciated actual cost RAB times a nominal WACC (a financial approach) basis. The MEU points out that this approach would significantly increase the cashflow acquired by the proponents in the early years of the project and require current end users higher prices so later end users get lower prices.
2. That the project have a different approach to depreciation where depreciation is incurred at the time of the expenditure rather than the current approach where depreciation is incurred from the completion of the project. The MEU

[1] ElectraNet: Project EnergyConnect Updated Cost Benefit Analysis 30 September 2020, page 23

points out that this change would also increase the cashflow acquired by the proponents in the early years of the project to the detriment of current end users.

The proponents have commented that unless these changes are implemented then the project is not financeable based on the current approach to setting of the WACC for networks. The MEU considers that this implies that the project has undergone a material change due to the need for changes to the regulatory approach in order to allow the project to be financeable. As a material change, the AER should require the project to be exposed to further detailed review by stakeholders.

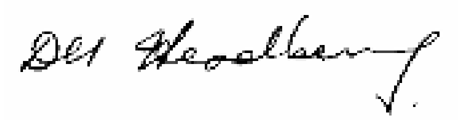
The MEU is aware that, while the proponents have used the inputs on which the 2020 ISP is based as the basis for assessing the benefits of the project, there is considerable doubt as to whether the values used are still valid. Specifically, the MEU is aware that the price for gas used in the 2020 ISP is likely to be much higher than the price for gas used for the 2022 ISP. The MEU is very concerned that the project is being assessed on the basis of historically assessed gas price inputs that more recent and available forecasts indicate are inflated, noting that the bulk of the benefits for the project are directly related to fuel cost savings, especially for gas fired generation.

The MEU is very concerned that the discount rate used to assess benefits of the project is the same as the current WACC used by the AER to generate the return on investments that have a very low risk attached to them. By using the regulated WACC as a discount rate for much more uncertain forecasts of future movements in the cost of inputs to assess benefits (especially the price for gas 40 years into the future) and for forecasts of electricity and demand for such a long period into the future, is inappropriate for incorporating such uncertainty and volatility. The MEU has sought advice from its members (also capital-intensive firms like the proponents) and they advise that they use much higher discount rates to reflect this future uncertainty and that they are loath to forecast benefits more than 15-20 years ahead.

In contrast, the proponents have used the very lowest possible discount rate allowed by the AER and forecast the benefits ahead for 40+ years in order to provide a view that the project delivers a net benefit.

The MEU is happy to discuss the issues further with you if needed or if you feel that any expansion on the above comments is necessary. If so, please contact the undersigned at [redacted]

Yours faithfully



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