12 May 2017

Business SA
Chamber of Commerce and Industry South Australia

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Working for your business.
Working for South Australia

Mr Sebastian Roberts
General Manager
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Dear Mr Roberts

I write in response to the AER's request for submissions on Murraylink's Revenue Proposal for the regulatory period 2018-23.

Executive Summary

- Business SA welcomes Murraylink's focus on real cost constraint in it's revenue proposal which is reflective of the reality facing business in South Australia.
- Rising network costs over the past decade have had a significant impact on the competitiveness of South Australian businesses, particularly manufacturers and irrigators, and given the wholesale market is now placing extreme pressure on price outcomes, it is even more critical that future Murraylink spending be contained.
- Murraylink plays an important role in connecting South Australia's electricity market with Victoria and access to firm interstate generation will continue to remain vital to the success of South Australia's economy.
- Relative to other network businesses, Murraylink's historical revenue recoveries from consumers have grown at relatively acceptable rates and Business SA would be concerned to see any justification for a step change from this approach.
- Business SA encourages Murraylink to look more holistically in relation to how a new control system can add value to contingent projects and create more cost efficiencies within its existing business to avoid higher cost recoveries from consumers, both now and through an increase in the regulatory asset base.

Should you require any further information or have questions, please contact
Andrew McKenna, Senior Policy Adviser, on (08) 8300 0000 or andrewm@business-sa.com.

Yours sincerely,

Anthony Penney
Executive Director, Industry and Government Engagement

Why this matter is important to South Australian businesses

As South Australia's Chamber of Commerce and Industry, Business SA is the peak business membership organisation in the State. Our members are affected by this matter in the following ways:

- After labour, electricity costs are the most significant concern for small business with the average small business electricity bill having doubled over the last decade from approximately $2,100 per annum to in excess of $4,250 per annum.[1]
- South Australia has the highest proportion of non-firm renewable generation in the National Electricity Market (NEM) and the withdrawal of Alinta's Northern Power Station in May 2016 has put significant pressure on South Australia's wholesale electricity market, effectively leaving two key players to hedge the base-load electricity needs of industry.
- Up until mid-2015 when South Australia's wholesale electricity prices began to rise dramatically, network costs had been the primary driver of the significant increases in electricity costs over the past decade and businesses cannot afford to return to the spending patterns associated with that period which have been compounded through rising regulated asset bases.
- South Australia's blackout on 28th September 2016 crystalised the importance of reliability to business and once the exact causes and their relative contributions to the system failure are determined by relevant inquiries, it will be important for Murraylink to take any reasonable steps required, at appropriate costs, to mitigate future impacts of similar events.

Key Policy Points

1. Business SA recognises Murraylink as an important electricity interconnection asset between Victoria and South Australia and acknowledges the increasingly important role that interconnection plays between States in the era of growing intermittent energy generation.

2. Business SA is concerned that Murraylink's revenue proposal from 2018-23, in 2018 real dollars, represents a 30% increase on the allowable revenue recovery over the 2013-18 regulatory period. On a trend basis, this is a significant step change and in contrast to the relatively stable revenue recovery profile of Murraylink over the past decade.

   Business SA recognises that total electricity demand in South Australia was growing for much of the decade up until the Global Financial Crisis (GFC) but that it has actually fallen 9.61% since 2010[2] while maximum demand has also declined in recent years, offset by the rising contribution of solar PV.

3. Business SA acknowledges Murraylink's capital expenditure proposal is twice its actual/expected expenditure over the current regulatory period, predominantly due to $27.2 million being spent on replacing its control system. Murraylink have advised ABB will no longer support their control and protection systems from 2021 which underlies the need for this reinvestment.

[1] SA Power Networks TSS presentation – August 2016
[2] Business SA calculations from AEMO historical data, http://aemo.com.au/Electricity/National-Electricity-Market-NEM/Data-dashboard#aggregated-data

As a consequence, the nominal value of Murraylink's regulatory asset base is forecast to increase from $114 million to $124 million. Murraylink's increased capital expenditure follows another step change in capital expenditure from the previous to current regulatory period, with capex of $16.6 million against the AER's allowed $5.9 million, albeit factoring in a $12.2 million fire suppression system in response to the 'Directlink' fire in 2012. Notwithstanding, Business SA acknowledges Murraylink's CAPEX over the past decade has been conservative relative to other network businesses and encourages the business to maintain an approach which appropriately balances shareholder and consumer interests.

Murraylink have not explained the extent to which its success or otherwise in building a new or enhanced interconnector under ElectraNet's regulatory investment test for transmission (RIT-T) proposal would impact on the size and nature of its required control system replacement. For example, there may be improved economies of scale or some other benefit which could flow back to consumers.

Furthermore, Murraylink have not articulated the improved productivity a new control system would deliver over a 15 year old and obsolete model, and how in turn that will reduce operating costs over 2018-23 and future revenue control periods.

4. South Australia's primary transmission company, ElectraNet, recently submitted its revenue proposal for the period 2019-23. In its rate of return calculations, Electranet have proposed a beta figure of 0.7, lower than the 0.8 figure proposed by Murraylink. Business SA would argue that Murraylink's beta should be at least equivalent to ElectraNet's beta calculation which is consistent with the AER's Rate of Return guideline.

5. Business SA acknowledges Murraylink's proposed operating expenditure (OPEX) is 5.6% above its actual/estimated OPEX for 2013-18. While Business SA understands there is some confidentiality around increases in OPEX related to asset maintenance and the AER has concerns about whether or not this step change is allowable, we do recognise Murraylink's efforts to keep real price growth at zero, including for labour costs. This reflects the weak state of South Australia's economy and our unemployment rate which remains the highest in the nation.[3]

   ESCOSA recently determined SA Water's revenues for the period 2016-20, a significant component of which related to labour costs. Considering all utility infrastructure companies employ a substantial number of technicians and engineers, Business SA expects drivers for SA Water's labour costs to be quite comparable to those experienced by Murraylink and we acknowledge the following comments from ESCOSA in reaching its decision on SA Water's labour costs:

   In doing so, it has reached the view that the base rate of increase in the cost of labour – which is an input to the calculation of SA Water's total labour costs – should be capped by the rate of change in the Australia wide Consumer Price Index (CPI). SA Water had proposed a base rate of change at half a percentage point above the CPI. However, given current evidence and economic circumstances in this State, the Commission is not persuaded that a higher base rate of change is prudent and efficient.

   Furthermore, ESCOSA stated '*SA Water did not propose any real labour cost escalation for its contracted delivery costs, suggesting that labour can be maintained within CPI for these externally delivered costs.'*

6. Murraylink's proposed post-tax nominal vanilla weighted average cost of capital (WACC), 6.54%, is forecast at half a percentage point above that of ElectraNet's 2019-23 revenue proposal post-tax nominal vanilla WACC of 6.02% and the AER should address the difference, if any is justified, between the two proposals.

[3] March Quarter Labour Force 2017, ABS