

Draft Decision

Directlink Transmission

Determination 2025 to 2030

(1 July 2025 to 30 June 2030)

Attachment 6

Operating expenditure

September 2024

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Inquiries about this publication should be addressed to:

Australian Energy Regulator
 GPO Box 3131
 Canberra ACT 2601
 Email: aerinquiry@aer.gov.au
 Tel: 1300 585 165

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6 Operating expenditure

Operating expenditure (opex) is the forecast of operating, maintenance and other non-capital costs incurred in the provision of network services. Forecast opex is one of the building blocks we use to determine a service provider's total regulated revenue requirement.

This attachment outlines our assessment of Directlink's proposed opex forecast for the 2025–30 regulatory control period.

6.1 Draft decision

Our draft decision is to not accept Directlink's proposed opex forecast of \$39.4 million (\$2024–25)¹, including debt raising costs.² This is because our alternative estimate of \$33.5 million is materially different (-\$5.9 million or 15.0% lower) from Directlink's total opex forecast proposal. Therefore, we consider that Directlink's total opex forecast does not reasonably reflect the opex criteria, having regard to the opex factors.³

Our draft decision is to include our alternative estimate of total forecast opex for the 2025–30 period of \$33.5 million. This draft decision is:

- \$5.9 million (15.0%) lower than Directlink's proposed opex for the 2025–30 period
- \$2.7 million (8.6%) higher than Directlink's actual and estimated opex for the 2020–25 period
- \$4.3 million (14.9%) higher than the opex forecast we approved for the 2020–25 period.

Directlink's 2020–25 actual (and estimated) opex of \$30.9 million is \$1.7 million or 5.5% above its approved forecast in that period.

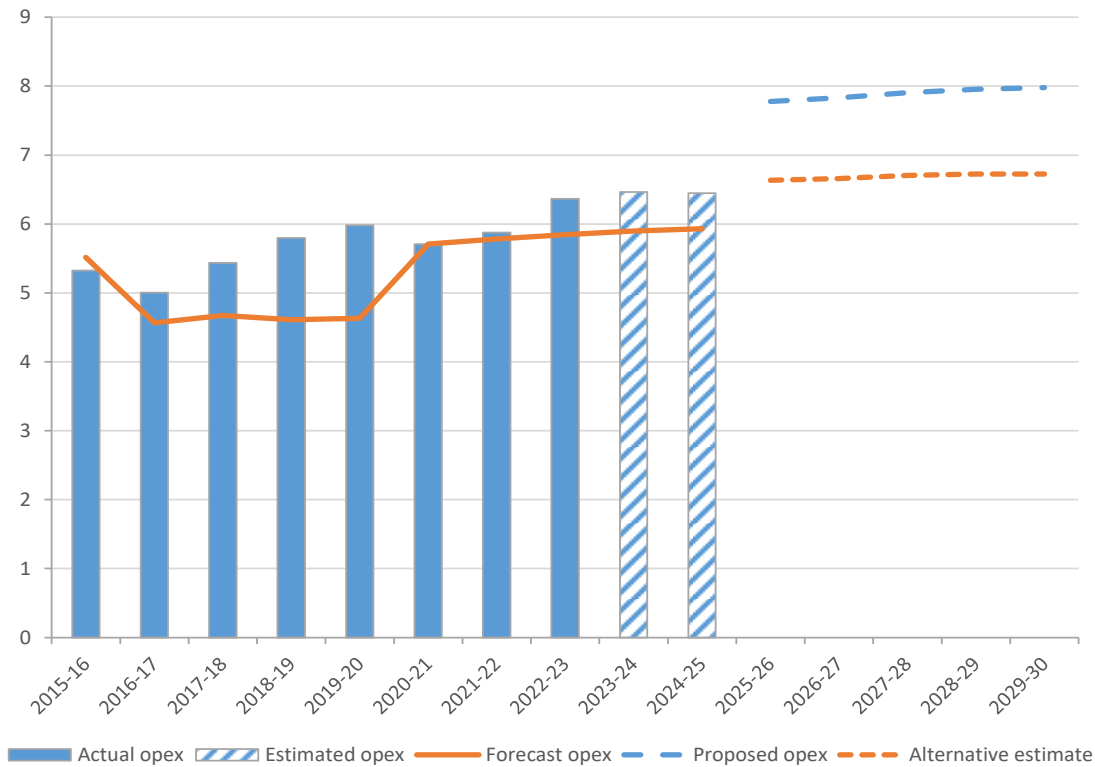
Figure 6.1 compares our alternative estimate of opex to Directlink's proposal for the next regulatory control period. We also show the forecasts we approved for the last two regulatory control periods and Directlink's actual and estimated opex over these periods.

¹ Directlink, *Attachment 05 - Operating Expenditure*, January 2024, p.1.

² All dollar amounts in this attachment reflect \$2024–25 terms, unless otherwise indicated.

³ The legal framework for our decision is set out in section 6.3 Assessment approach.

Figure 6.1 Historical and forecast opex (\$2024–25)



Source: Directlink, 2019-20 - Annual Regulatory Accounts - RIN Response - Consolidated, 20 October 2020; Directlink, 2022-23 - Regulatory Accounts - RIN Response - Consolidated, 12 October 2023; Directlink, Attachment 09d - Forecast Opex model, 24 January 2024; AER analysis.

Table 6.1 sets out Directlink’s opex proposal, our alternative estimate for the draft decision and the differences between these forecasts.

Table 6.1 Comparison of Directlink’s proposal and our draft decision on opex (\$million, 2024–25)

	Directlink Proposal	AER Draft Decision	Difference (\$)	Difference (%)
Based on reported opex	32.0	31.8	-0.2	-0.5%
Efficiency adjustment	-	-	-	0.0%
Base year non-recurrent efficiency gains	-	-	-	0.0%
Security of Critical Infrastructure (SoCI) Act. Adjustment	0.7	0.7	-	0.0%
Total base year adjustments	0.7	0.7	-	0.0%
2022–23 to 2024–25 increment	0.4	0.4	-0.0	0.0%
Remove category specific	-5.3	-5.3	0.1	0.2%

	Directlink Proposal	AER Draft Decision	Difference (\$)	Difference (%)
forecasts				
Trend: Output growth	-	-	-	0.0%
Trend: Price growth	0.5	0.7	0.2	0.4%
Trend: Productivity growth	-	-0.5	-0.5	-1.2%
Total trend	0.5	0.2	-0.3	-0.8%
Apprenticeship program	0.9	-	-0.9	-2.2%
Total step changes	0.9	-	-0.9	-2.2%
Category specific forecasts	10.0	5.3	-4.7	-11.9%
Total opex, excluding debt raising costs	39.1	33.1	-6.0	-15.2%
Debt raising costs	0.4	0.5	0.1	0.2%
Total opex (including DRC)	39.4	33.5	-5.9	-15.0%

Source: Directlink, *Attachment 09d - Forecast Opex model*, 24 January 2024; AER analysis.

Note: Numbers may not add up to total due to rounding. Differences of '0.0' and '-0.0' represent small variances and '-' represents zero.

Our lower alternative estimate of total opex for Directlink is primarily due to:

- removal of Directlink’s proposed category specific forecast to set aside provision for end of life costs (-\$4.7 million or -11.9%)
- removal of Directlink’s proposed apprenticeship program step change (-\$0.9 million or -2.2%)
- inclusion of a productivity growth factor (-\$0.5 million or -1.2%).

6.2 Directlink’s proposal

Directlink’s proposal applied a “base-step-trend” approach to forecast opex for the 2025–30 regulatory control period, consistent with our standard approach.

In applying our base step trend approach to forecast opex, Directlink:⁴

- used reported opex in 2022–23 as the base from which to forecast (\$6.4 million or \$32.0 million over the next regulatory control period)

⁴ Directlink, *Attachment 09d - Forecast Opex model*, 24 January 2024.

- adjusted its total base year forecast opex by adding \$0.7 million (\$2024–25) for costs required to comply with revised obligations under the Security of Critical Infrastructure (SoCI) Act
- subtracted \$5.3 million of category specific costs to account for the removal of opex categories forecast separately from its base opex
- added an estimate of the difference between the base year opex and the opex it will incur in the final year of the current regulatory period, increasing opex by \$0.4 million
- applied its overall rate of change forecast to its final year adjusted opex estimate, increasing opex by \$0.5 million. This reflected price growth of \$0.5 million, but no amounts for output growth or productivity growth
- added one step change totalling \$0.9 million for apprenticeship costs
- added two category specific forecasts totalling \$10.0 million for:
 - end of life costs (\$4.7 million)
 - insurance premium costs (\$5.3 million)
- added \$0.4 million of debt raising costs to arrive at a total opex forecast of \$39.4 million over the 2025–30 regulatory control period.

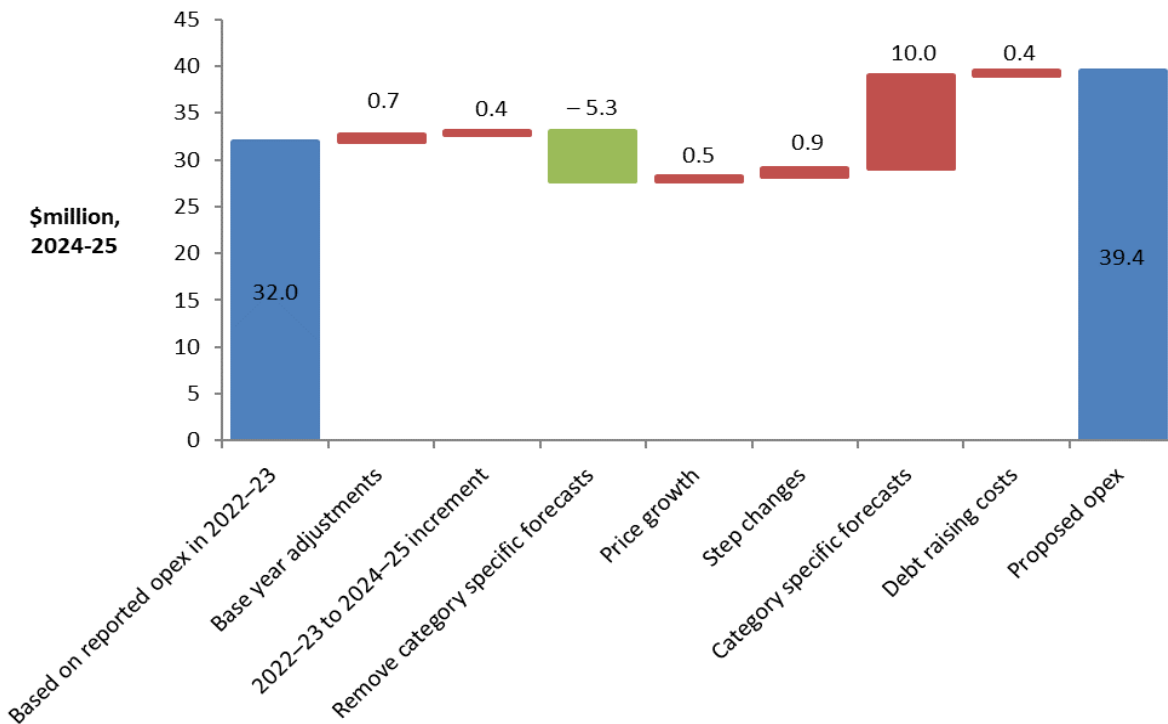
Table 6.2 Directlink’s opex for the 2025–30 period (\$million, 2024–25)

	2025–26	2026–27	2027–28	2028–29	2029–30	Total
Total Opex, excluding debt raising costs	7.7	7.8	7.8	7.9	7.9	39.1
Debt raising costs	0.1	0.1	0.1	0.1	0.1	0.4
Total Opex, including debt raising costs	7.8	7.8	7.9	8.0	8.0	39.4

Source: Directlink, *Attachment 09d - Forecast Opex model*, 24 January 2024; AER analysis.

Note: Numbers may not add up to total due to rounding.

Figure 6.2 shows the different components that make up Directlink’s opex forecast for the 2025–30 regulatory control period.

Figure 6.2 Directlink’s proposed opex (\$million, 2024–25)

Source: Directlink, *Attachment 09d - Forecast Opex model*, 24 January 2024; AER analysis.

Note: Numbers may not add up to total due to rounding.

6.2.1 Stakeholder views

We received one submission on Directlink’s proposal which discussed opex issues, from the Energy Users Association of Australia (EUAA).

At a high level, the EUAA submitted that:⁵

- it did not support Directlink’s apprenticeship program step change, as it considers these costs were already covered by base opex
- it did not support Directlink’s insurance premium cost step change (however, we note that Directlink did not propose a step change for its insurance costs, rather, these are ongoing costs included as a separate category specific forecast)
- it agreed with the concept of Directlink setting aside an amount for end of life costs.

We have taken the EUAA’s submission into account in developing the positions set out in this draft decision.

⁵ EUAA, *Submission – 2025-30 Electricity Determination – Directlink*, May 2024.

6.3 Assessment approach

Our role is to decide whether to accept a business's total opex forecast. We are to form a view about whether a business's forecast of total opex 'reasonably reflects the opex criteria'.⁶ In doing so, we must have regard to the opex factors specified in the National Electricity Rules (NER).⁷

The *Expenditure forecast assessment guideline* (the Guideline), together with an explanatory statement, sets out our assessment approach in detail.⁸ While the Guideline provides for greater regulatory predictability, transparency and consistency, it is not mandatory. However, if we make a decision that is not in accordance with the Guideline, we must state the reasons for departing from the Guideline.⁹

Our approach is to assess the business's forecast opex over the regulatory control period at a total level, rather than to assess individual opex projects. To do so, we develop an alternative estimate of total opex using a 'top-down' forecasting method, known as the 'base-step-trend' approach.¹⁰ We compare our alternative estimate with the business's total opex forecast to form a view on the reasonableness of the business's proposal. If we are satisfied the business's forecast reasonably reflects the opex criteria, we must accept the forecast.¹¹ If we are not satisfied, we must reject the business's forecast¹² and substitute it with our alternative estimate that we are satisfied reasonably reflects the opex criteria.¹³

In making this decision, we take into account the reasons for the difference between our alternative estimate and the business's proposal, and the materiality of the difference. Further, we take into consideration interrelationships between opex and the other building block components of our decision.¹⁴

Figure 6.3 summarises the 'base-step-trend' forecasting approach.

⁶ NER, cl. 6A.6.6(c).

⁷ NER, cl. 6A.6.6(e).

⁸ AER, *Expenditure forecast assessment guideline - transmission*, November 2013; AER, *Explanatory statement - Expenditure forecast assessment guideline*, November 2013.

⁹ NER, cl. 6A.2.3(c).

¹⁰ A 'top-down' approach forecasts total opex at an aggregate level, rather than forecasting individual projects or categories to build a total opex forecast from the 'bottom up.'

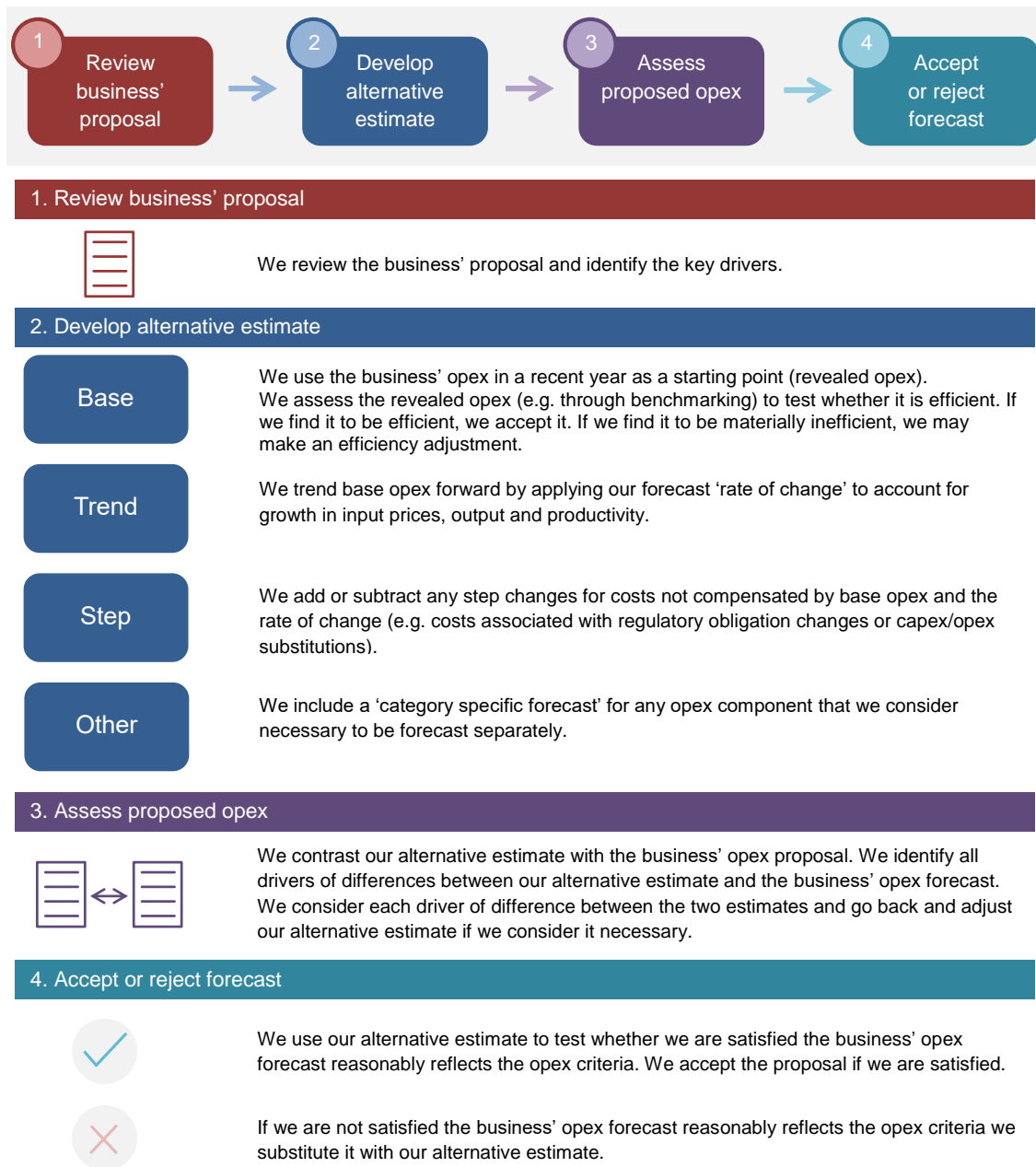
¹¹ NER, cl. 6A.6.6(c).

¹² NER, cl. 6A.6.6(d).

¹³ NER, cl. 6A.14.1(3)(ii).

¹⁴ We are required to consider these interrelationships under s. 16(1)(c) of the NEL.

Figure 6.3 Our opex assessment approach



6.3.1 Interrelationships

In assessing Directlink’s total forecast opex, we also take into account other components of its proposal that could interrelate with our opex decision. The matters we considered in this regard included:

- the efficiency benefit sharing scheme (EBSS) carryover—the level of opex used as the starting point to forecast opex (the final year of the current regulatory control period) should be the same as the level of opex used to forecast the EBSS carryover. This consistency ensures that the business is rewarded (or penalised) for any efficiency gains (or losses) it makes in the final year the same as it would for gains or losses made in other years

- the operation of the EBSS in the 2020–25 regulatory control period, which provided Directlink an incentive to reduce opex in the base year
- the impact of cost drivers that affect both forecast opex and forecast capital expenditure (capex). For instance, forecast labour price growth affects forecast capex and our forecast price growth used to estimate the rate of change in opex
- the approach to assessing the rate of return, to ensure there is consistency between our determination of debt raising costs and the rate of return building block
- the outcomes of Directlink’s engagement with consumers and stakeholders in developing its proposal and any feedback we have had.

6.4 Reasons for draft decision

We do not accept Directlink’s proposed total opex forecast of \$39.4 million, including debt raising costs, for the 2025–30 regulatory control period because we are not satisfied that it reasonably reflects the opex criteria, having regard to the opex factors.

Our draft decision is to include our alternative estimate of \$33.5 million, which is \$5.9 million or 15.0% lower than Directlink’s forecast. We are satisfied our alternative estimate of total forecast opex for Directlink reasonably reflects the opex criteria.

Table 6.1 sets out Directlink’s proposal, our alternative estimate that is the basis for the draft decision, and the difference between our draft decision and the proposal.

The main drivers for the differences are also set out in Section 6.1 and we discuss the components of our alternative estimate, and our assessment of Directlink’s proposal, below. Full details of our alternative estimate are set out in our opex model, which is available on our website.

6.4.1 Base opex

This section provides our view on the prudent and efficient level of base opex that we consider Directlink would need for the safe and reliable provision of electricity services over the 2025–30 regulatory control period.

6.4.1.1 Proposed base year

Directlink proposed a base year of 2022–23 and used an estimate of base year opex of \$6.4 million or \$32.0 million over the five years of the next regulatory period.¹⁵ Directlink submitted that it selected 2022–23 as its base year because¹⁶:

- it is the most recent audited financial year
- it is most reflective of current conditions and a typical year of operations on the Directlink interconnector

¹⁵ Directlink, *Attachment 05 - Operating Expenditure*, January 2024, p.9.

¹⁶ Directlink, *Attachment 05 - Operating Expenditure*, January 2024, p.9.

- no adjustments are required for non-recurrent expenditure or for inefficient recurrent operating expenditure
- it reflects a ‘revealed cost’ approach as preferred by the AER.

Consistent with our preferred approach, we consider it is reasonable for Directlink to use 2022–23 as the base year. This is because it reflects audited actual opex for a recent year which we consider is reasonably representative of the nature of base opex costs that are required for the next regulatory control period.

We have updated the base opex amount for 2022–23 to \$31.8 million (over 5 years). The difference between Directlink’s proposed amount and our alternative is due to the use of different inflation forecasts. We have used the latest inflation forecasts published by the Reserve Bank of Australia (RBA). We consider these inflation forecasts are the best forecast possible in the circumstances because they reflect the most up-to-date information available.

6.4.1.2 Efficiency of Directlink’s base opex

As summarised in section 6.3, and in the Guideline, our preferred approach for forecasting opex is to use a revealed cost approach. This is because opex is largely recurrent and stable at a total level.

We are satisfied that Directlink’s opex in 2022–23 is representative of its efficient opex requirements for the 2025–30 regulatory control period. This is because Directlink faces financial incentives under the regulatory framework in the current regulatory control period to incur only efficient costs. This gives us comfort that the actual level of opex incurred should provide a good estimate of the efficient costs required for it to operate a safe and reliable network and meet its relevant regulatory obligations.

Directlink has been subject to the incentives of an ex ante regulatory framework including the application of an EBSS in the 2020–25 regulatory control period. This is designed to give it a continuous incentive to reduce (or not overspend) its opex throughout the 2020–25 regulatory control period, including its proposed base year. While Directlink would receive a higher opex forecast under the revealed cost forecasting approach as a result of overspending in the base year against our previous opex forecast, it also receives a negative EBSS carryover of -\$0.6 million. The EBSS shares all opex overspend and underspend relative to our opex forecast between Directlink and consumers, providing a disincentive for Directlink to spend more than necessary to operate its network.

Generally speaking, these incentives mean we can somewhat rely on the revealed cost forecasting approach to forecast Directlink’s opex for the 2025–30 regulatory control period, in the absence of any benchmarking (given that Directlink is an interconnector), unless there is clear evidence of material inefficiency. While there is some evidence of Directlink historically overspending relative to its opex forecast in previous periods (see Figure 6.1), we are not satisfied that this is evidence of material inefficiency. We are also mindful of Directlink’s relatively small size and contribution to consumer bills.

In addition, as noted below in section 6.4.2.3, we are also proposing to include a negative productivity forecast for Directlink in the 2025–30 regulatory period, to encourage good industry practice.

6.4.1.3 Adjustments to base year opex

Directlink proposed a total adjustment to its base opex of \$0.13 million or \$0.7 million over the forecast period. This adjustment relates to Directlink’s compliance with the SoCI Act.

We have considered this proposed adjustment and have included it in our alternative estimate of opex in the base year to account for Directlink’s compliance obligations under the SoCI Act. We discuss this adjustment further below.

6.4.1.3.1 Security of Critical Infrastructure Act

Directlink submitted that its 2022–23 base year included only six months of costs required to comply with revised obligations under the SoCI Act.¹⁷

Directlink therefore proposed an adjustment to its base year of \$0.13 million (\$0.7 million over the forecast period) to reflect the full costs attributable to complying with reforms to the SoCI Act.

The SoCI costs attributable to APA have previously been identified and allocated to the Victorian Transmission System (VTS) and Murraylink revenue determinations as approved by the AER¹⁸. The allocation of a share of these costs to Directlink occurs under APA’s Management, Operations and Maintenance and Commercial Services Agreement (MOMCSA) as the expenditure is required to meet statutory and regulatory requirements.¹⁹

We are satisfied that these SoCI costs are necessary for Directlink to comply with its statutory and regulatory obligations, and have been appropriately allocated to Directlink similarly to allocations previously approved for the Murraylink and VTS determinations.

Accordingly, we have included Directlink’s adjustment for these costs in our alternative estimate of total forecast opex.

6.4.1.3.2 Final year increment

Our standard practice to calculate ‘final year opex’ is to add the estimated change in opex between the base year (2022–23) and the final year (2024–2025) of the current (2020–25) period to the base year opex amount.²⁰

We have included \$0.4 million for the final year increment in our alternative estimate, which is the same as Directlink’s proposed amount.

¹⁷ Directlink, *Attachment 05 - Operating Expenditure*, January 2024, pp. 9–10.

¹⁸ AER, *Murraylink 2023-28 – Final Decision – Overview, April 2023*, pp. 20–21; AER, *Final Decision – APA VTA 2023-27 Access Arrangement – Attachment 6 – Operating Expenditure*, December 2022, p. 27.

¹⁹ Directlink, *Attachment 05b – Outsourcing Arrangements*, January 2024, pp. 2–3

²⁰ AER, *Expenditure forecast assessment guideline - transmission*, November 2013, pp. 24–25.

6.4.2 Rate of change

Having determined an efficient starting point, or base opex, we trend it forward to account for the forecast growth in prices, output and productivity. We refer to this as the rate of change.²¹

Directlink largely applied our standard approach to forecasting the rate of change. It proposed:²²

- **Price growth:** to adopt the input price weightings of 52.7% labour and 47.3% non-labour, as used in our annual benchmarking report. It forecast labour price growth using a forecast wage price index (WPI) growth (for all of Australia) from its consultant, BIS Oxford Economics.
- **Output growth:** consistent with its 2020–25 period determination, Directlink proposed output growth of 0%.
- **Productivity growth:** consistent with its 2020–25 period determination, Directlink proposed productivity growth of 0%.

Directlink’s proposed rate of change contributed \$0.5 million to its total opex forecast of \$39.4 million. This equates to opex increasing 1.6% on average each year. In our alternative estimate we have included an opex rate of change of 0.6% on average each year. We compare the forecasts in Table 6.3, and reasons for the differences are set out below.

Table 6.3 Forecast annual rate of change in opex (%)

	2025-26	2026-27	2027-28	2028-29	2029-30
Directlink’s proposal					
Price growth	0.7	0.6	0.5	0.6	0.7
Output growth	-	-	-	-	-
Productivity growth	-	-	-	-	-
Rate of change	0.7	0.6	0.5	0.6	0.7
AER alternative estimate					
Price growth	1.1	0.7	0.6	0.7	0.9
Output growth	-	-	-	-	-
Productivity growth	0.6	0.6	0.6	0.6	0.6
Rate of change	1.7	1.3	1.2	1.3	1.5
Difference	1.1	0.7	0.7	0.7	0.8

Source: Directlink, *Attachment 09d - Forecast Opex model*, 24 January 2024, AER analysis.

Note: The rate of change = $(1 + \text{price growth}) \times (1 + \text{output growth}) \times (1 - \text{productivity growth}) - 1$.
Numbers may not add up to totals due to rounding. Amounts of '0.0' and '-0.0' represent small non-zero values and '-' represents zero.

²¹ AER, *Expenditure forecast assessment guideline - transmission*, November 2013, pp. 25–26.

²² Directlink, *Attachment 05 - Operating Expenditure*, January 2024, pp. 11–12.

6.4.2.1 Forecast price growth

Directlink proposed average annual price growth of 0.6%, which increased its total opex forecast by \$0.5 million.²³ The average annual real price growth we used in our alternative estimate was approximately 0.8%. This increases our total opex alternative estimate by \$0.7 million. The differences between the price growth in Directlink’s proposal and our alternative estimate is explained by the underlying inflation series used and the averaging method employed by the AER (which averaged 2 NSW-specific WPI forecasts).

Both we and Directlink forecast price growth as a weighted average of forecast labour price growth and non-labour price growth:

- While Directlink only used the WPI forecast from its consultant, BIS Oxford Economics, we used an average of two WPI growth forecasts for the electricity, gas, water and waste services (utilities) industry to forecast labour price growth, consistent with our standard approach. We have used WPI forecasts from BIS Oxford Economics²⁴, and Deloitte Access Economics (DAE). We sourced the DAE forecasts from the August 2024 DAE report published with this draft decision.²⁵
- both we and Directlink applied a forecast non-labour real price growth rate of zero.
- Directlink applied its historic weights to account for the proportions of opex that are labour and non-labour, 52.7% and 47.3%, respectively. We have updated these weights to our current standard transmission weights, consistent with our transmission benchmarking, which are 70.4% for labour and 29.6% for non-labour.

Consequently, the difference between our real price growth forecasts and Directlink’s largely arises from our method of averaging two WPI forecasts, updated labour and non-labour weights, and using more recent inflation data.

Table 6.4 compares our forecast labour price growth with Directlink’s proposal.

Table 6.4 Forecast labour price growth, %

	2025–26	2026–27	2027–28	2028–29	2029–30
Directlink’s proposal					
BIS Oxford Economics	1.3	1.1	0.9	1.2	1.3
AER’s alternative estimate					
DAE	1.1	0.8	0.7	0.9	1.1
BIS Oxford Economics	1.2	1.1	0.9	1.2	1.3

²³ Directlink, *Attachment 09d - Forecast Opex model*, 24 January 2024.

²⁴ Jemena Gas Network, *Oxford Economics – Att 5.5 – Input cost escalation*, April 2024, p. 21.

²⁵ DAE, *Labour Price growth 2024, final forecasts*, 16 August 2024

	2025–26	2026–27	2027–28	2028–29	2029–30
Average	1.1	1.0	0.8	1.0	1.2
Superannuation guarantee increases	0.5				
Average (including superannuation guarantee increases)	1.6	1.0	0.8	1.0	1.2
Overall difference	0.3	-0.1	-0.1	-0.2	-0.1

Source: Directlink, *Attachment 09d - Forecast Opex model*, 24 January 2024; DAE, *Labour Price growth 2024, draft forecasts*, 29 July 2024; AER analysis.

Note: Numbers may not add up to totals due to rounding. Values of '0.0' and '-0.0' represent small non-zero amounts and '-' represents zero.

6.4.2.2 Forecast output growth

Consistent with its 2020–25 period determination, Directlink has proposed output growth of 0.0%. Directlink does not consider it has any potential for output growth as it is a point to point interconnector available to AEMO for dispatch as required.

Directlink's proposed output growth is consistent with the output growth forecast applied in our recent 2023–28 Murraylink (also an interconnector) final decision. We propose to accept Directlink's proposed 0.0% output growth figure on this basis.

6.4.2.3 Forecast productivity growth

Directlink has similarly applied a productivity growth forecast of 0.0% in its initial proposal. This is consistent with our 2020–25 final determination. Directlink submitted that:²⁶

- its operating costs are largely fixed and the opportunity for productivity gains are severely limited, and
- it has already taken a conservative approach in escalating its base year by restricting the real escalation of cost inputs to labour only. It would therefore be inappropriate to apply a productivity improvement measure.

However, our proposed position for our alternative estimate for this draft decision is to maintain consistency with our more recent decision for Murraylink's 2023–28 final determination. Murraylink, like Directlink, is a point to point interconnector that did not previously have productivity growth applied in its past decisions. In our recent Murraylink final decision we stated that:²⁷

²⁶ Directlink, *Attachment 05 - Operating Expenditure*, January 2024, p. 12.

²⁷ AER, *Murraylink 2023–28 – Draft Decision – Attachment 6 – Operating Expenditure*, September 2022, p. 8.

“We note that Murraylink previously did not have a productivity growth forecast and did not forecast productivity growth for the 2023–28 period. However, we consider it prudent to include a productivity forecast in our alternative estimate, as we consider a productivity growth factor captures the improvements in good industry practice that should be implemented by efficient operators as part of business-as-usual operations (e.g. through new technology or management practice changes).”

For this reason, we therefore propose to include a productivity growth forecast of 0.6% per year in our alternative estimate of total opex for Directlink, which is our standard productivity factor for transmission networks.

6.4.3 Step changes

In developing our alternative estimate for the draft decision, we include prudent and efficient step changes for cost drivers such as new regulatory obligations or efficient capex / opex trade-offs. As we explain in the Guideline, we will generally include a step change if the efficient base opex and the rate of change in opex of an efficient service provider does not already include the proposed cost for such items and they are required to meet the opex criteria.²⁸

6.4.3.1 Apprenticeship program step change

Directlink’s proposal included one step change, for apprenticeship program costs, totalling \$0.9 million or 2.2% of its proposed total opex forecast.

Directlink proposed a step change of \$0.9 million over the 2025–30 regulatory control period for its participation in the APA apprenticeship program. Our draft decision is to not include this step change in our alternative estimate.

Table 6.5 Directlink’s apprenticeship program step change (\$million, 2024–25)

	2025–26	2026–27	2027–28	2028–29	2029–30	Total
Directlink’s proposal	0.17	0.17	0.17	0.17	0.17	0.9
AER draft decision	-	-	-	-	-	-
Difference	-0.17	-0.17	-0.17	-0.17	-0.17	-0.9

Source: Directlink, *Attachment 09d - Forecast Opex model*, 24 January 2024, AER analysis.

Note: Numbers may not add up to totals due to rounding. Values of '0.0' and '-0.0' represent small non-zero amounts and '-' represents zero.

Directlink proposed that it will participate in the APA apprenticeship program from February 2024 and fund a single apprentice to the cost of \$0.17 million per annum. It submitted that

²⁸ AER, *Expenditure forecast assessment guideline - transmission*, November 2013, p. 24.

the need to fund an APA apprentice is driven by ageing of the existing skilled workforce and the increasing shortage of key workers in the utilities sector.²⁹

Directlink is owned by Energy Infrastructure Investments Pty Limited (EII). Management, operations and maintenance of all EII assets are outsourced to APA Group via the Management, Operations and Maintenance and Commercial Services Agreement (MOMCSA), as are all corporate functions of EII. APA recovers all contract costs and its direct overheads, plus a 10% margin, from EII via the MOMCSA³⁰. Entry into the MOMCSA was viewed as a means by which EII could access economies of scale, scope and other efficiencies, along with relevant expertise, that it would not otherwise be able to obtain on a stand-alone basis.

We consider that:

- a prudent business should be addressing workforce planning issues on an ongoing, business as usual basis.
- some APA Group apprenticeship program costs may already be included in Directlink’s base opex, either through the direct charge of labour to specific projects, or via the allocation of APA overheads to EII.
- the use of an apprenticeship program to address workforce resilience issues does not align with our standard criteria for a step change as set out in the Better Resets Handbook, specifically.³¹
 - the expenditure is not linked to a new regulatory obligation
 - the expenditure does not represent a capex/opex substitution, and is not supported by a cost-benefit analysis
 - the costs relate to a business decision to enhance workforce resilience, and so are not driven by a major external change outside the control of the business that Directlink is unable to manage under forecast opex.

We further consider that allowing a step change for an apprenticeship or similar training program in these circumstances is not appropriate, given staffing costs and managing workforce resilience issues are an ongoing business as usual matter for all businesses. There is no underlying step change in work volumes or complexity that might necessitate a step increase in labour resources.

The EUAA, in its submission, also stated that it did not support this step change due to its immateriality and because it considered that the costs of an apprentice should already be covered in Directlink’s base year opex.³²

²⁹ Directlink, *Attachment 05 - Operating Expenditure*, January 2024, pp. 12–13.

³⁰ Directlink, *Attachment 05b – Outsourcing Arrangements*, January 2024, pp. 2–3

³¹ AER, *Better Resets Handbook*, July 2024, pp. 26–27.

³² EUAA, *Submission – 2025-30 Electricity Determination – Directlink*, May 2024.

For the reasons outlined above, we have excluded these costs from our alternative estimate of total forecast opex.

6.4.4 Category specific forecasts

Directlink’s proposal included three category specific forecasts, which were not forecast using the base-step-trend approach. These were for end of life costs, insurance premiums and debt raising costs. We have not included the category specific forecast for Directlink’s end of life costs in our alternative estimate of total opex, but we have included the category specific forecasts for its insurance premiums and debt raising costs.

We discuss these in turn below.

6.4.4.1 End of life costs

Directlink proposed a category specific forecast of \$4.7 million over the 2025–30 period to start setting aside funds for its expected future end of life costs.³³ Our draft decision is to not include this amount in our alternative estimate.

Table 6.6 Directlink’s end of life costs (\$million, 2024–25)

	2025–26	2026–27	2027–28	2028–29	2029–30	Total
Directlink’s proposal	0.94	0.94	0.94	0.94	0.94	4.7
AER draft decision	-	-	-	-	-	-
Difference	-0.94	-0.94	-0.94	-0.94	-0.94	-4.7

Source: Directlink, *Attachment 09d - Forecast Opex model*, 24 January 2024; AER analysis.

Note: Numbers may not add up to totals due to rounding. Values of '0.0' and '-0.0' represent small non-zero amounts and '-' represents zero.

Directlink submitted that it is currently expected to operate until 2041–42, in accordance with the estimated technical life of its converter stations. Once Directlink has ceased operations, it submitted that it will be required to remove any equipment and rehabilitate the land it currently occupies to comply with relevant laws, planning standards and agreements, and make the site safe for the community and the environment. The costs associated with these activities are considered “end of life costs” by Directlink and it considers them likely to be significant.³⁴

Directlink is proposing to set aside an annual amount totalling \$4.7 million over the 2025–30 period, determined using an annuity method, to provide for its expected end of life costs. Under this approach, an amount would be recovered every year up until 2041–42 for these expected future costs.

³³ Directlink, *Attachment 05 - Operating Expenditure*, January 2024, pp. 16–19.

³⁴ Directlink, *Attachment 05 - Operating Expenditure*, January 2024, pp. 16–17.

Directlink submitted that, while it recognises there is a significant amount of uncertainty surrounding when Directlink will cease to operate and what the future costs for asset removal and land rehabilitation will be, end of life costs will necessarily be incurred eventually and its customers will be required to pay these costs, either now or in the future. Directlink submitted that it considers it is in the long-term interest of customers to start recovering these costs from this (2025–30) regulatory period as:³⁵

- extending the payment over a longer period reduces the price impact on consumers;
- it harnesses the time value of money with the accumulated interest reducing the direct payments that need to be made by consumers; and
- the consumers who benefit from the operation of Directlink are paying the end of life costs, rather than future customers.

Our 2020–25 determination

Directlink proposed a similar provision mechanism for end of life costs (which it referred to as ‘land restoration costs’) in its 2020–25 proposal, which we did not accept in our final decision. This was due to our findings that the prudence and efficiency of these costs was too uncertain and not well justified, principally due to:³⁶

- the uncertainty that the costs will be incurred. If Directlink were to be upgraded or replaced instead of being removed, costs could be capitalised as part of the replacement/refurbishment project. It is not clear an appropriate mechanism exists under the NER to return accumulated opex to consumers if not required.
- the uncertainty regarding Directlink’s expected life to 2042. If Directlink is ultimately retired, the timing will depend on a number of factors including actual asset condition and future market circumstances. This uncertainty brings into question the quantum of costs needed at that future point in time and the prevailing laws, standards and other obligations that Directlink may need to comply with.
- any potential ‘price shock’ experienced by consumers due to Directlink recovering its end of life costs when they become certain would be immaterial in the context of consumer bills due to the relatively small size of Directlink’s cost base.

What has changed in Directlink’s current proposal

Directlink’s current proposal to recover end of life costs in the 2025–30 period is the same as its proposal for the 2020–25 period, apart from the fact Directlink is now seeking to recover only its estimated asset removal costs, and not the land remediation costs previously

³⁵ Directlink, *Attachment 05 - Operating Expenditure*, January 2024, pp. 17.

³⁶ AER, *Directlink 2020-25 – Final Decision – Attachment 6 – Operating Expenditure*, June 2020, pp. 12–17.

included. Directlink submitted that it considered this approach mitigates some of the uncertainty around the quantum of costs required.³⁷

Directlink provided the below table in its proposal to illustrate the change in its annual allowance to recover its future asset removal costs only (in bold) as opposed to its asset removal and land remediation costs (option B) based on an end of life in 2042.

Table 6.7 Directlink’s forecast end of life costs

Options	End of Life cost		Discount rate (%)	Years remaining (no.)	Annual Allowance \$000
	\$2019-20	\$2041-42			
A) 2020-25 Determination	15.0	23.1	1.05	21.2	900
B) 2025-30 Determination	15.0	29.1	4.98	16.2	1,200
C) Asset removal only	11.6	22.5	4.98	16.2	940
D) C + 10 year extended life.	11.6	28.2	4.98	26.2	560

Source: Directlink, *Attachment 05 - Operating Expenditure*, January 2024, p. 15.

We note that the EUAA, in its submission on Directlink’s 2025-30 revenue proposal, submitted that they “agree with the concept of current consumers contributing to end of life costs.”

AER assessment and conclusions

Having considered Directlink’s proposal, we consider that the considerations and arguments against Directlink starting to recover its end of life costs well in advance of its expected end of life, as set out in our 2020–25 revenue determination, are still valid. Namely:

- there is significant uncertainty around when Directlink will reach the end of its economic life and what might happen to the asset at that time. No additional information or certainty has been provided in Directlink’s current proposal to mitigate this. As a result, the prudence and efficiency of these costs cannot be adequately justified at this time.
- while the principle of assigning costs to the customers who benefit from the operation of Directlink rather than future customers may have merit, any potential benefit to consumers of Directlink starting to recover these costs now (such as costs being spread over a greater period) is outweighed by the uncertainty of the quantum, timing and likelihood of such costs being incurred, and the risk of potential over-recovery.
- it could, conversely, be argued that current customers are less likely to benefit from this end of life expenditure than future customers – the benefits of asset removal or land rehabilitation will accrue to future customers at the end of Directlink’s life through increased site safety, community amenity, and environmental benefits at that time.

³⁷ Directlink, *Attachment 05 - Operating Expenditure*, January 2024, p. 17.

- Directlink’s argument that its proposed approach harnesses the time value of money, with the accumulated interest reducing the payments that need to be made by consumers, is not persuasive. This benefit of ‘compound interest’ would otherwise accrue to consumers directly through lower bills over time.
- any potential ‘price shock’ from Directlink recovering the totality of these costs in a single regulatory period, when they fall due and can be forecast with certainty, will unlikely have a material effect on electricity consumers given Directlink’s small size and minor contribution to total bills.

For these reasons, we have excluded these costs (\$4.7 million) from our alternative estimate of total forecast opex for this draft decision.

6.4.4.2 Insurance premium costs

Directlink proposed a category specific forecast of \$5.3 million over the 2025–30 regulatory control period for its insurance premium costs. Our draft decision is to include this amount in our alternative estimate.

Table 6.8 Directlink’s insurance premium costs (\$million, 2023–24)

	2025–26	2026–27	2027–28	2028–29	2029–30	Total
Directlink’s proposal	1.00	1.02	1.07	1.09	1.08	5.3
AER draft decision	1.00	1.02	1.07	1.09	1.08	5.3
Difference	-	-	-	-	-	-

Source: Directlink, *Attachment 09d - Forecast Opex model*, 24 January 2024; AER analysis.

Note: Numbers may not add up to totals due to rounding. Values of '0.0' and '-0.0' represent small non-zero amounts and '-' represents zero.

Insurance premium costs were separately forecast in Directlink’s 2020–25 revenue determination as we found that insurance costs represented a higher proportion of opex for Directlink than other network service providers, and so, consequently, its total opex was more sensitive to changes in the insurance market as a result.³⁸

Directlink considers this reasoning still holds and therefore proposed to continue to forecast its insurance costs separately as a category specific forecast. Directlink has estimated its insurance costs to be \$1.1 million per year, or \$5.3 million over the regulatory period. This equates to approximately 13% of total forecast opex.

This is an increase of \$0.7 million from actual and estimated expenditure in the current period. Directlink’s forecast is based on a report from Marsh which provided insurance

³⁸ AER, *Draft decision, Directlink 2020–25 Attachment 6 - Operating expenditure*, October 2019, pp. 17–19.

premium projections in relation to Directlink for the period from 1 July 2025 to 30 June 2030.³⁹

Based on our review of Directlink’s proposal and the supporting evidence provided, we are satisfied that Directlink’s estimate is likely to reflect a reasonable expectation of insurance market conditions and insurance premium costs for the 2025–30 regulatory period. We have therefore included these costs in our alternative estimate of total opex.

6.4.4.3 Debt raising costs

We have included debt raising costs of \$0.5 million in our alternative estimate, which is \$0.1 million higher than Directlink’s proposed amount for debt raising costs of \$0.4 million.

Table 6.9 Debt raising costs (\$million, 2023–24)

	2025–26	2026–27	2027–28	2028–29	2029–30	Total
Directlink’s proposal	0.1	0.1	0.1	0.1	0.1	0.4
AER alternative estimate	0.1	0.1	0.1	0.1	0.1	0.5
Difference	0.0	0.0	0.0	0.0	0.0	0.1

Source: Directlink, *Attachment 09d - Forecast Opex model*, 24 January 2024; AER analysis.

Note: Numbers may not add up to totals due to rounding. Values of '0.0' and '-0.0' represent small non-zero amounts and '-' represents zero.

Debt raising costs are transaction costs incurred each time a business raises or refinances debt. Our preferred approach is to forecast debt raising costs using a benchmarking approach rather than a service provider’s actual costs in a single year. This provides consistency with the forecast of the cost of debt in the rate of return building block.

We used our standard approach to forecast debt raising costs, which is discussed further in Attachment 3 to the draft decision.

³⁹ Directlink, *Attachment 05c – Marsh Insurance Pricing Report*, January 2024, pp. 16–17.

Shortened forms

Term	Definition
AER	Australian Energy Regulator
capex	capital expenditure
DAE	Deloitte Access Economics
Directlink	Directlink Joint Venture
EBSS	efficiency benefit sharing scheme
MOMCSA	Management, Operations and Maintenance and Commercial Services Agreement
NEL	national electricity law
NEO	national electricity objective
NER	National Electricity Rules
NSP	network service provider
opex	operating expenditure
RBA	Reserve Bank of Australia
RIN	regulatory information notice
SoCI	Security of Critical Infrastructure