

# The Australian Energy Regulator



SP AusNet Transmission  
Draft Decision 2014-17  
Predetermination  
conference  
18 September 2013

# Agenda

- 10.00 - 10.15 Registration
- 10.15 - 10.45 Andrew Reeves, Chairman AER
- 10.45 - 11.30 Bruce Mountain, Director CME on behalf of EUAA
- 11.30 - 12.00 Discussion

# Our approach to the review

- We consider all available relevant information and then use judgement and a broader array of interconnecting information to arrive at a balanced decision
- Total revenue cap set out by assessing the 'building block' elements
- Reviewed material, key assumptions and inputs
- Review of governance and asset management practices and framework

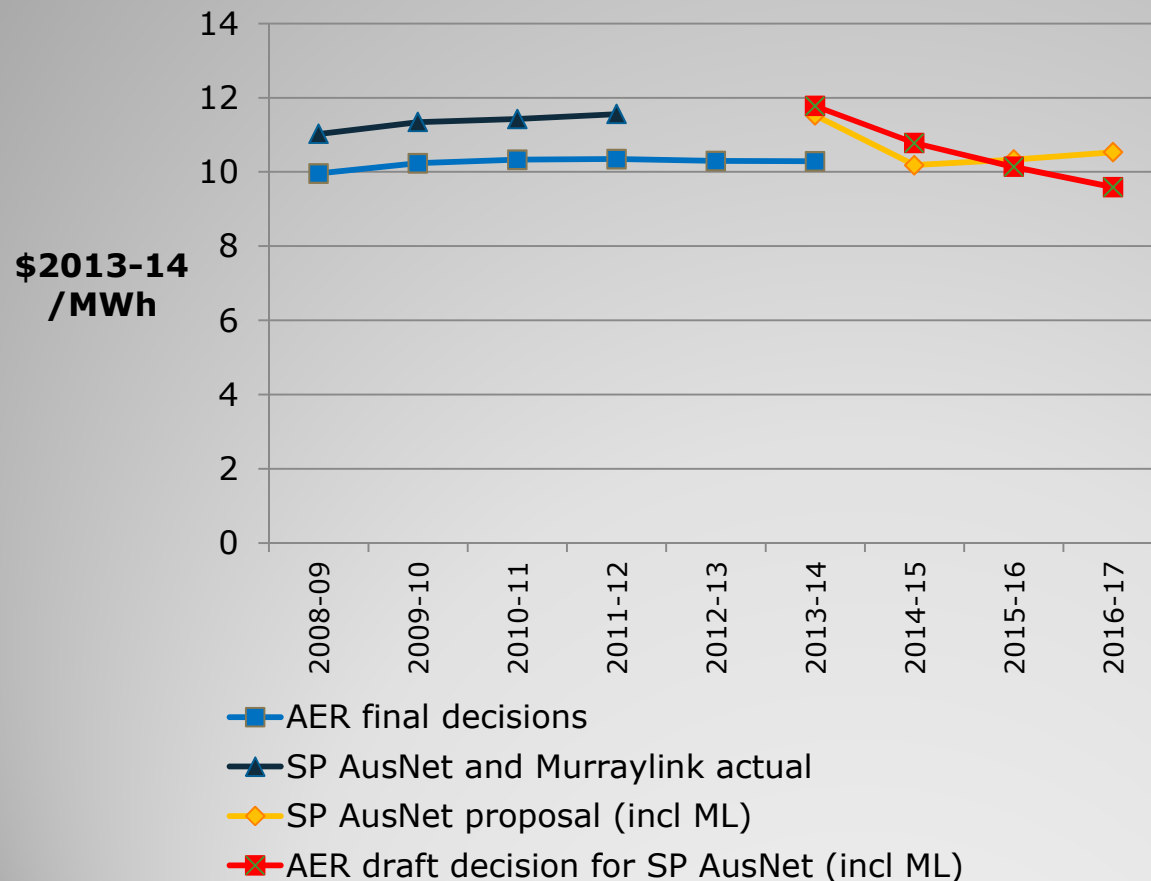
# Technical consultants

- EMCa/Strata - technical engineering
- AM Actuaries - insurance/self insurance
- Deloitte Access Economics - labour cost escalation
- McGrathNichol - cost allocation

# Key issues

- In general, the proposal from SP AusNet is largely consistent with the rules, so our draft decision is not far from the proposal provided by SP AusNet
- But there are a few key issues we want to highlight
- In capex the major divergences are:
  - major station rebuilds - but late stage issue at West Melbourne
  - IT - strategic costs
  - Prudence and cost estimation
- In opex the major divergences are:
  - overall approach - no bottom up builds
  - SP AusNet claimed efficiency benefits through the EBSS (this is fine). However, under SP AusNet's approach, consumers will never benefit from these savings.

# Price impact



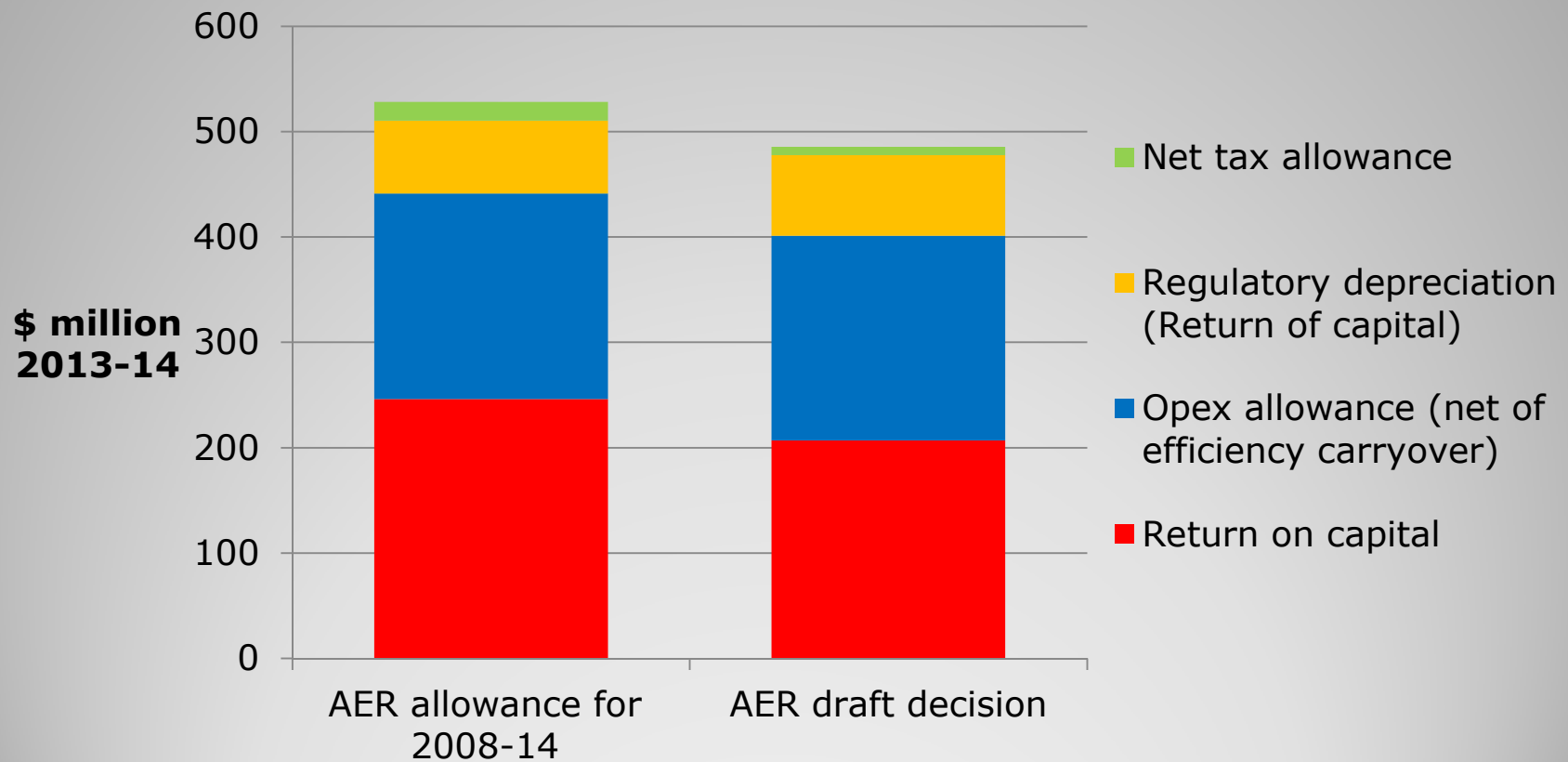
## Key points

- Average transmission charges will decrease by 6.6% per annum (nominal) from 1 April 2014
- Could be significant for large industrial customers
- $P_o = 7.3\%$  real or  $5.0\%$  nominal
- Forecast energy delivered is increasing (1.5% pa)

# Maximum Allowed Revenue

- \$1528 million (\$nominal)
- 4.4% less than proposed
- Average annual allowance (excl EBSS) will decrease by 8.1% (\$2013-14) compared with 2008-14
  - Return on capital - decrease (\$246m pa to \$207m pa, \$2013-14)
  - total opex - about the same (\$195m pa, \$2013-14)
  - tax allowance - decrease (\$18m pa to \$8m pa, \$2013-14)
  - depreciation - increased (\$69m pa to \$76m pa, \$2013-14)
- X-factor 4.26%

# Revenue impact (average annual allowance)





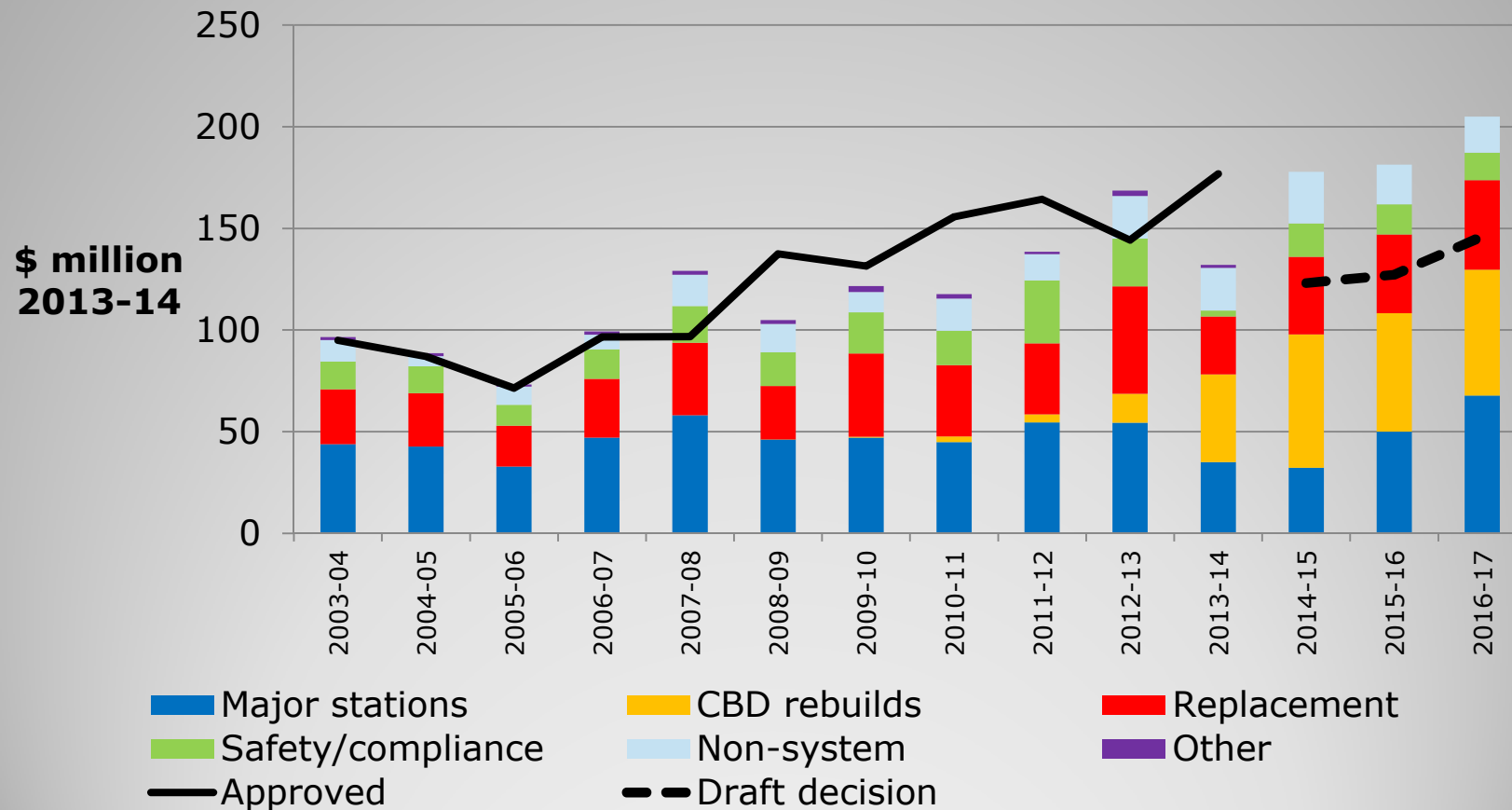
# Revenue impact our adjustments compared with proposal

	MAR \$ million	AER adjustment \$ million	AER adjustment %
SP AusNet proposed	1597.8		
Opening RAB		1.1	0.1
WACC		22.4	1.4
Capex review		-16.0	-1.0
Opex review		-67.9	-4.2
EBSS		-11.1	-0.7
Other		4.4	0.3
AER unsmoothed revenue	1530.7		-4.2
AER smoothed revenue	1528.1		-4.4

# Cost of capital

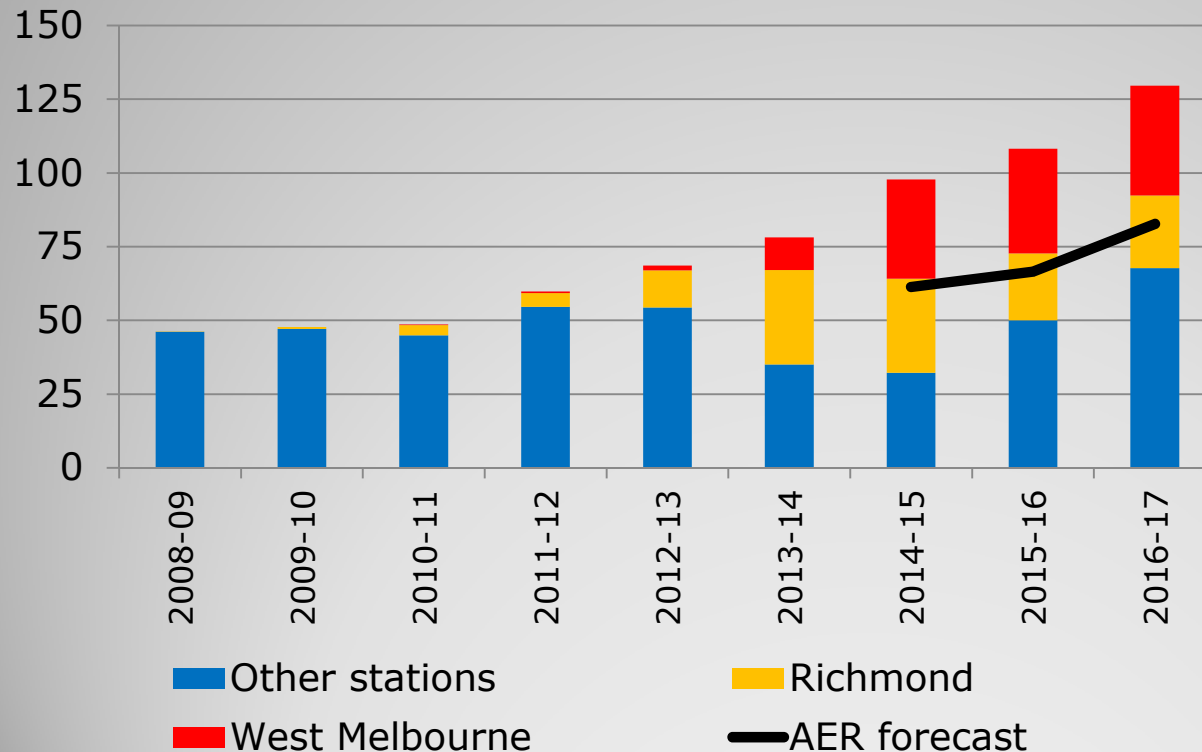
- Nominal vanilla WACC 7.43%
  - Higher than proposed (7.19%) because of risk free rate
  - If current risk free rate applies in the averaging period then WACC (and revenue) will go up for final decision
- Indicative averaging period for draft decision
- RF rate - 3.54%
- DRP - 3.00%
- Other WACC parameters - 2009 AER WACC review

# Capex review



# Major station rebuilds

\$ million  
2013-14



## Key points

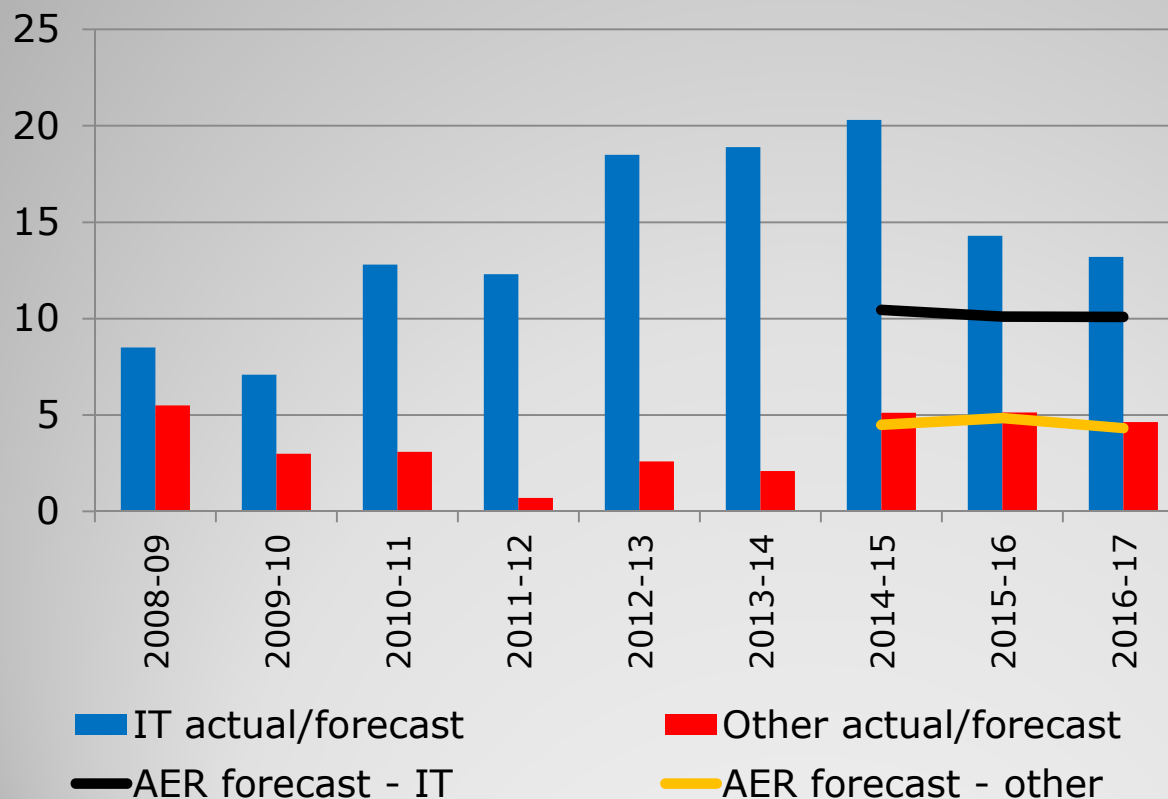
- WMTS-project required but late stage issue, costs/timing too uncertain for ex ante allowance
- Individual project costing generally sound but portfolio adjusted for prudence and estimation bias

# Prudency and cost estimation adjustments

- Prudency adjustment-\$26.4 million
  - Portfolio has been aggregated on historical outcomes
  - Continuous improvements to SP AusNet's capex program
  - Actual capex expected to be less than forecast
  - Adjustment based on average differences for site-specific projects and programs of work observed between what was forecast and actual capex in current period
- Cost estimation forecast bias-\$3.9 million
  - 1.4% adjustment
  - Overestimation bias stemming from labour cost estimates not based on competitive outcomes and other method issues

# Non-system capex

\$ million  
2013-14

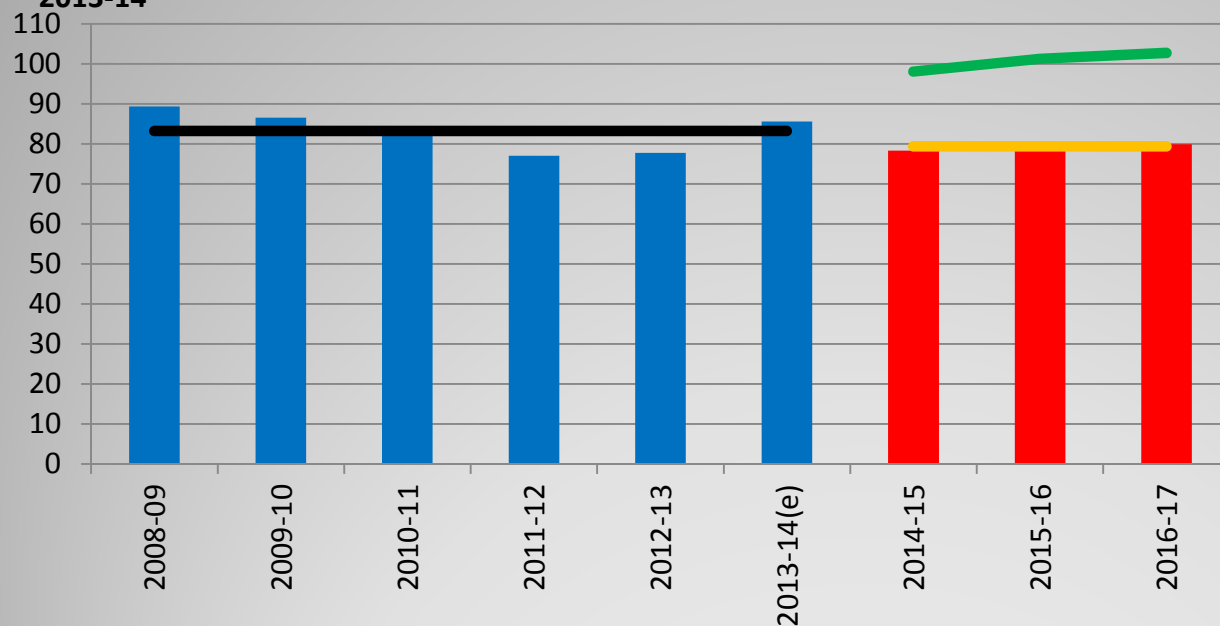


## Key points

- 76% of non-system capex proposed is for IT
- \$16.8 million strategic IT costs-not accepted
- Other non-system costs-accepted

# Opex review

\$ million  
2013-14



■ Total opex\*

■ AER draft decision

— Average 2008-14

— SP AusNet proposal

— Average 2014-17 draft decision

## Key points

- Insurance-not accepted
- Asset works-not accepted
- AIS-no allowance, awaiting RRP position
- Self insurance-not accepted

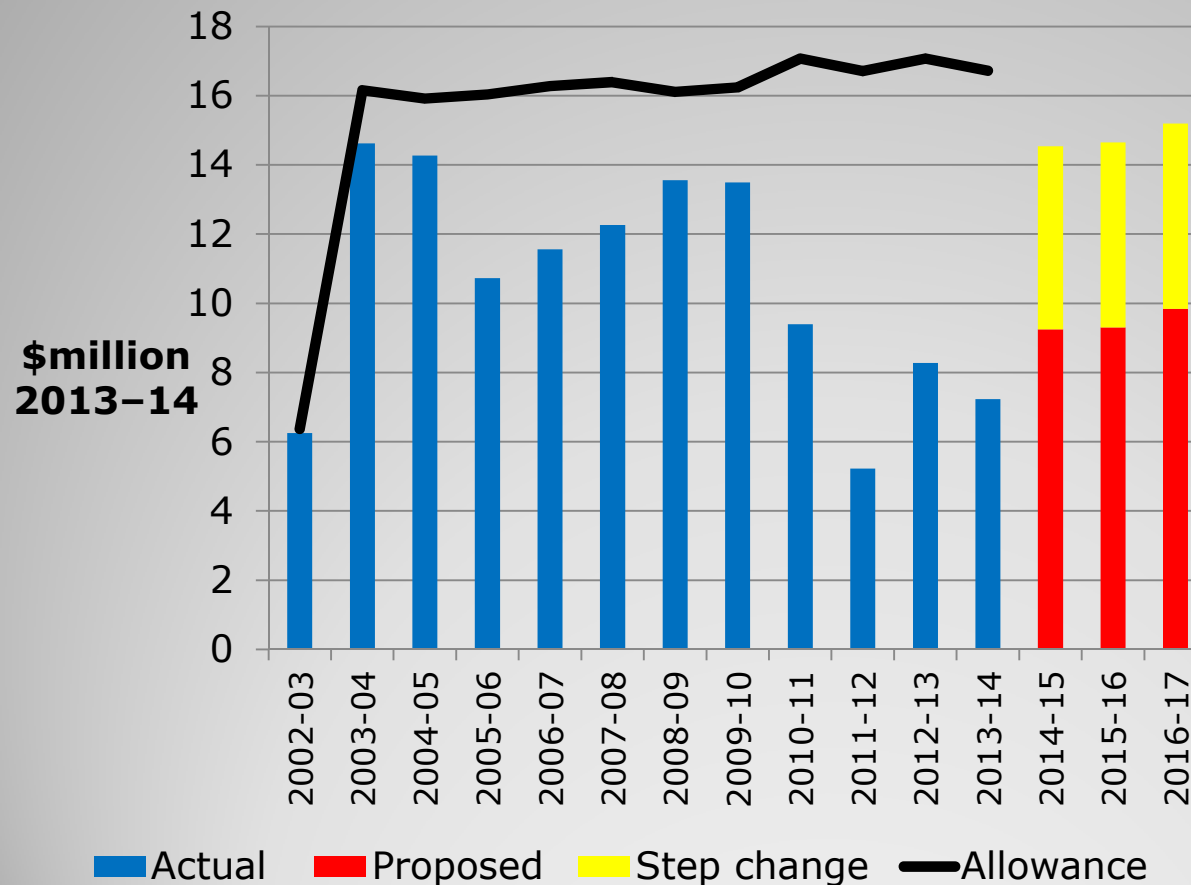
\*non-controllable opex excludes land and easement tax in this chart

# Base-step-trend issues

- We used base-step-trend method to forecast all controllable opex
- Base year: 2011-12 (accepted)
- Step changes: \$2.9 million of \$32.5 million proposed
- Network growth: proposed approach accepted
- Economies of scale: adjusted



# Asset works

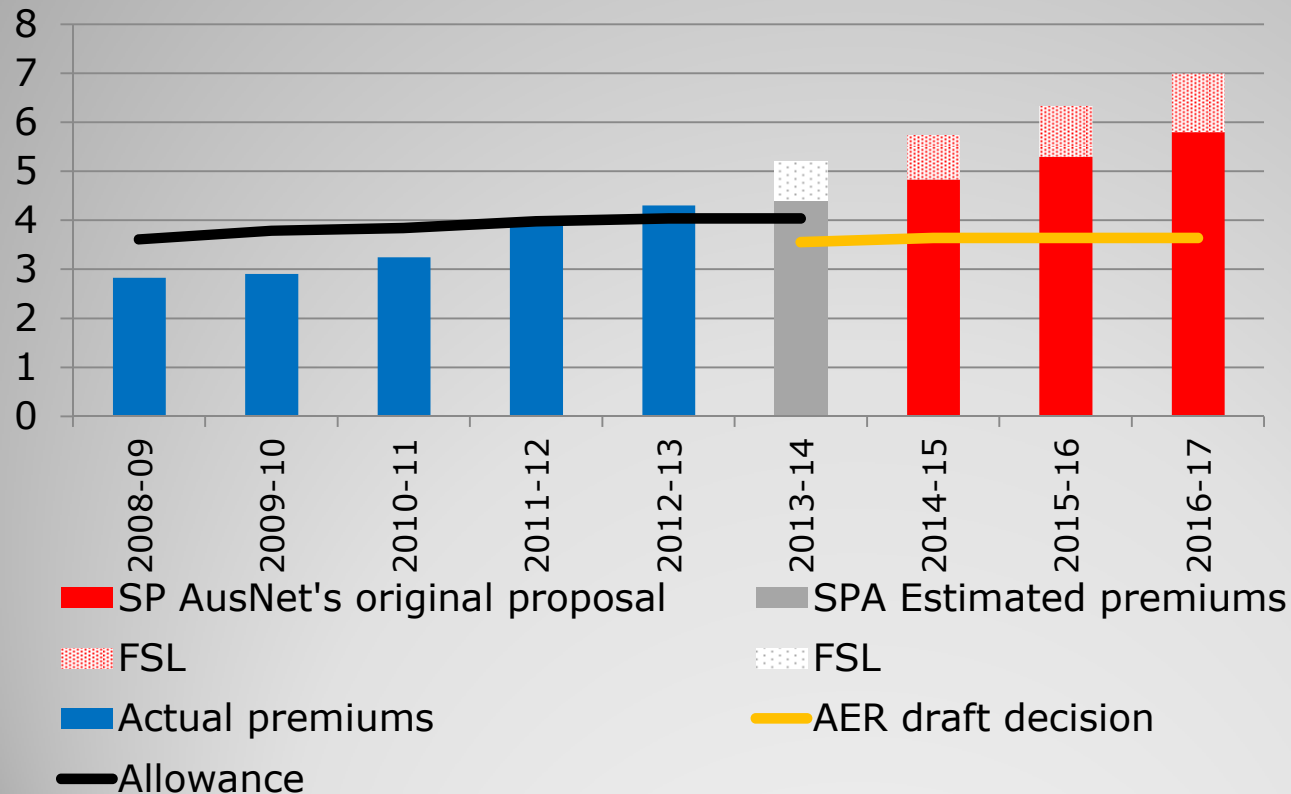


## Key points

- Asset works is a hybrid forecast-comprised of bottom up and step changes
- Historical underspending-\$44m in current period
- EBSS benefit should be shared with customers through incentive framework
- \$44m proposed, allowance \$16m

# Insurance

\$ million  
2012-13



## Key points

- Removed FSL
- Cost re-allocation
- CIC adjustments
- Step change for market repricing
- Insurance escalators

# EBSS

- Carryover \$38.7 million (proposed \$47.1m)
- Reasons for difference:
  - Five year carryover period - \$6.9m
  - Removed movements in provisions - \$0.3m
  - Updated 2012-13 (estimated) data with audited data - \$2.5m

# Material/labour escalation

- labour escalation- not accepted
- We adopted DAE labour forecast
- We removed the inclusion of a labour component in materials
- Materials updated with recent data (updated for recent data)

Labour	2012-13	2013-14	2014-15	2015-16	2016-17
Internal	1.1	0.5	1.0	1.0	1.2
External	0.1	0.0	0.6	1.0	1.4

# STPIS

- Good historical service performance
- New STPIS will apply in 2014-17 to focus on unplanned outages and improved network capability. Comprises 3 components:
  - Service component
    - Reject adjustment to loss of supply or for increased capex
    - Applied different distributions to calculate caps/collars for 'loss of supply > 0.3 minutes' and 'material failure of SCADA' sub-parameters
  - Network capability component
    - AEMO endorsed SP AusNet's project plan (which includes 22 projects)
    - We accepted this plan
  - Market impact component
    - targets not set in decision - set on a rolling basis each year
    - revised MIC data will be reviewed for final decision

## Other matters

- Contingent projects - we did not accept any of the 3 proposed
- Opening RAB \$2872.8 million (nominal)
  - Equity raising cost capitalised
  - 2007-08 estimate and actual capex adjustments
- Depreciation - accept proposed standard asset lives
- Tax - accept proposed method
- Nominated cost pass throughs - changes to definitions
- Pricing methodology - accept
- Negotiation framework - accept

## Next steps

- In response to our draft decision SP AusNet can submit a revised revenue proposal. We must, then, make a final decision.
  - SP AusNet revised revenue proposal - 10 October 2013
  - Public submissions - 1 November 2013
  - Final decision - 31 January 2014
  - Regulatory control period commences - 1 April 2014
- Stakeholders are invited to participate in these regulatory processes, and we aim to assist consumers in their engagement with us. Useful information for consumers can be found:
  - AER guide to this draft decision (<http://www.aer.gov.au>)