

AER Draft Determinations Energex and Ergon Energy 2010–11 to 2014–15

Mr Steve Edwell
Chairman
8 December 2009

Key messages

- Energex and Ergon network investment to rise over 2010 – 2015
 - security, safety and reliability
- Capex of nearly \$10.7 billion, up 29% (real)
- Opex of \$3.1 billion, down 2% (real)
- Implications for small retail customers
 - charges to rise by \$133 (9%) in 2010-11 and
 - \$31 a year (2%) thereafter

Qld electricity distribution reset

- Framework and Approach issued November 2008
- Proposals lodged 30 June 2009
 - Included responses to regulatory information notices
 - Consistent with framework and approach
- Comprehensive review process
 - Public forum held (here) in August
 - Submissions received (28 August 2009)
 - Reviewed by expert consultants (PB, MMA and others)
- Draft determinations and consultants reports published
 - 30 November 2009

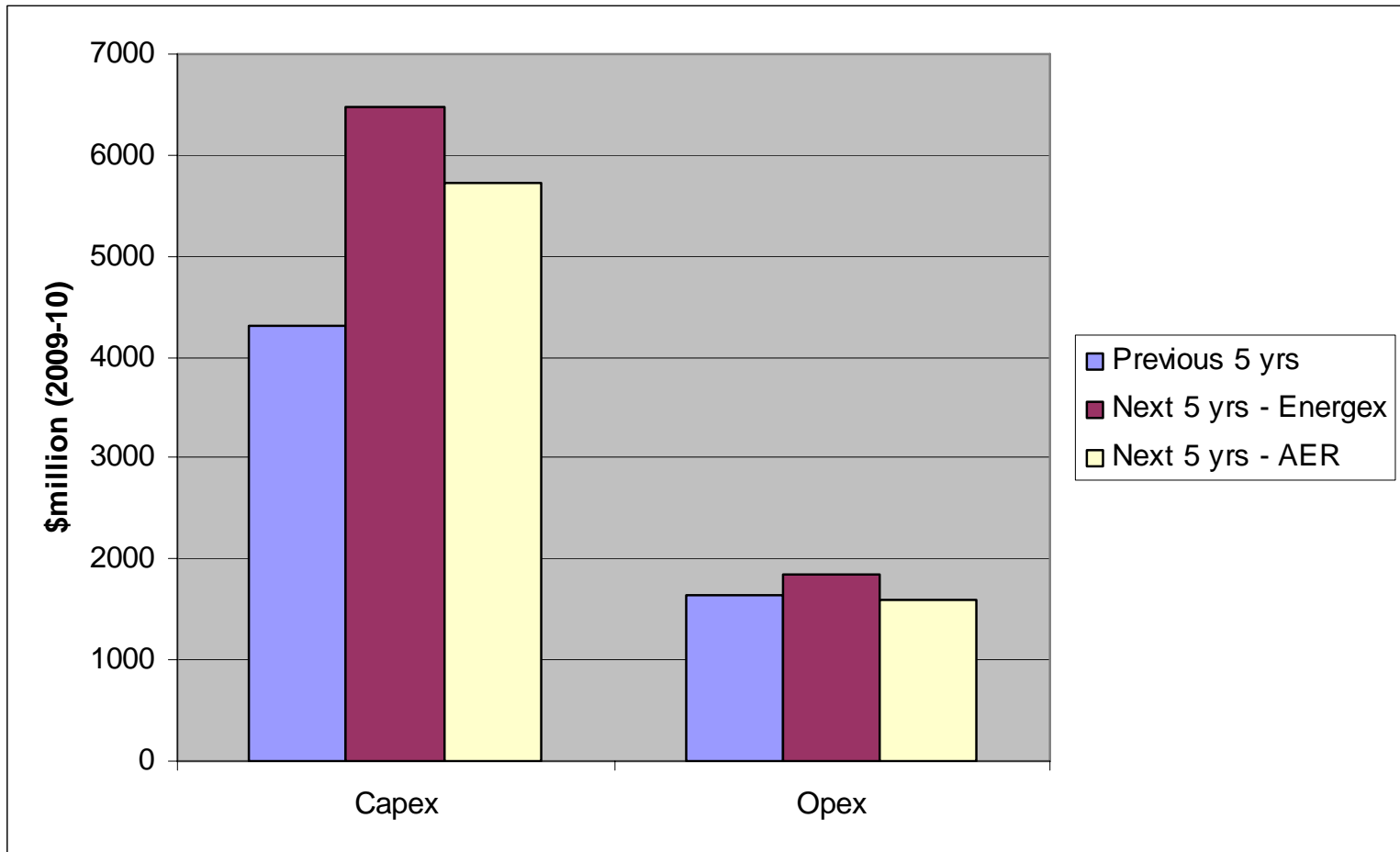
Key drivers

- Improving the safety and reliability of the networks
 - EDSD and ‘good electricity industry practice’
- Customer growth
 - Population growth and resources boom
- Growth in peak energy demand
 - Air conditioners, summer peak demand is here to stay
 - Demand management emerging
- Replacement of aging assets
 - Reliability and network security

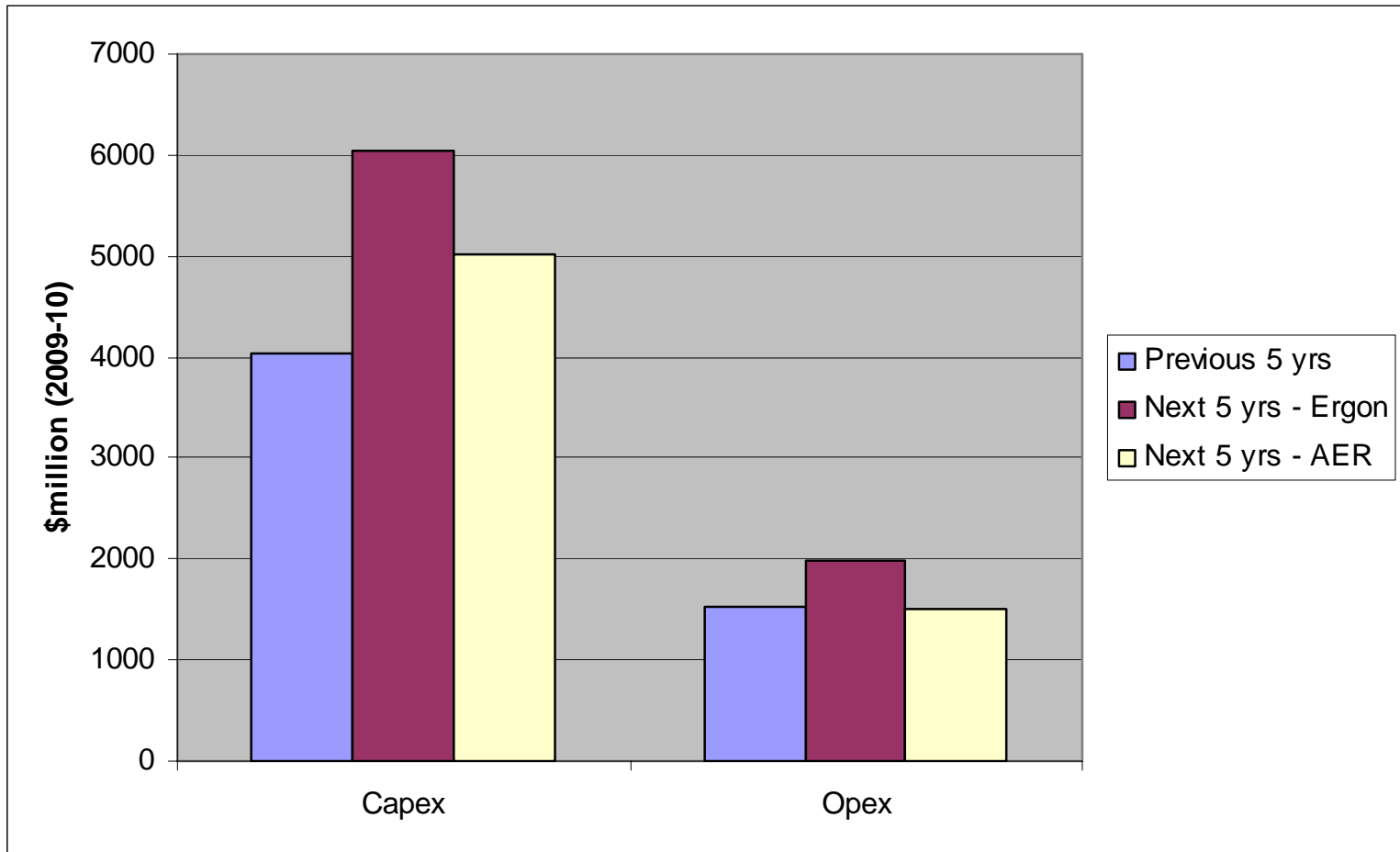
Implications

- Higher capex driving total investment and hence investment cost
- Opex to stay around current levels in real terms

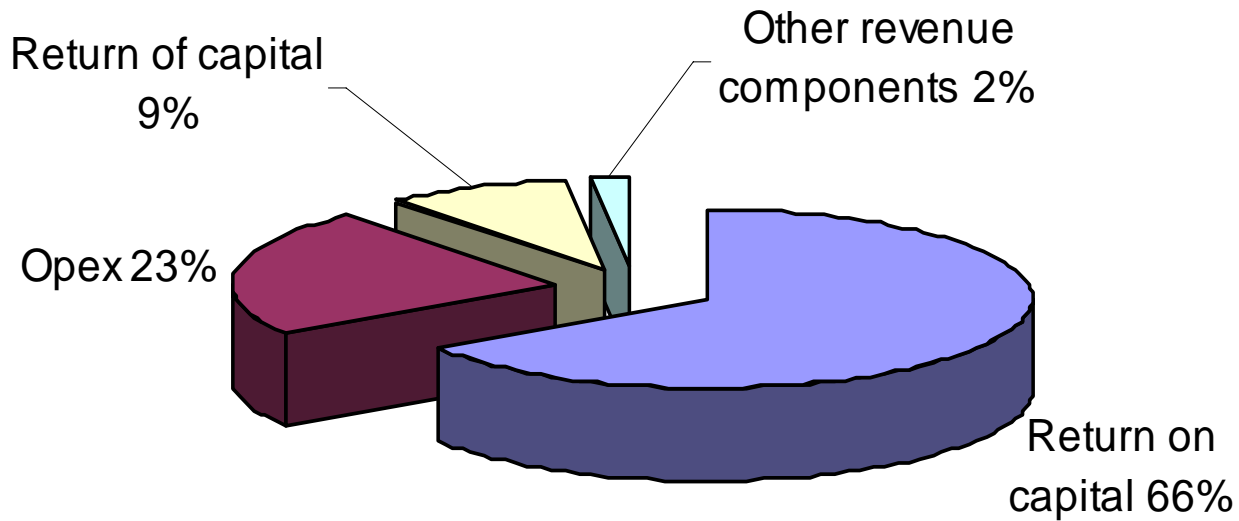
Energex capex and opex



Ergon Energy capex and opex



Total revenue



Total revenue = \$13.5 billion

Cost of capital

- Energex and Ergon Energy:
 - largely adopted the AER's parameters but sought the inclusion of a convenience yield
 - proposed a WACC of 9.49%
- AER:
 - did not accept the convenience yield
 - has approved a WACC of 10.06%
 - will update the WACC for the final decision.

Indicative price impacts

- Revenue X factors (real)
 - Energex 19% next year, then 3% (Energex sought 20.8% and 4.5%)
 - Ergon 22.9% next year, then 1.2% (Ergon sought 23.3% and 4.6%)
- Average residential customer charges in 2010-11 up **9%**, or around **\$133** per year.
- Beyond 2010-11, around **2%** or **\$31** each year
- These numbers are indicative only

New incentive arrangements

- AER introducing incentive schemes to the Qld distributors:
 - service target performance incentive scheme
 - efficiency benefit sharing scheme
 - demand management incentive scheme
- Aims to improve service quality, encourage efficiency and manage demand.

Questions



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AER Draft determination: Energex 2010–11 to 2014–15

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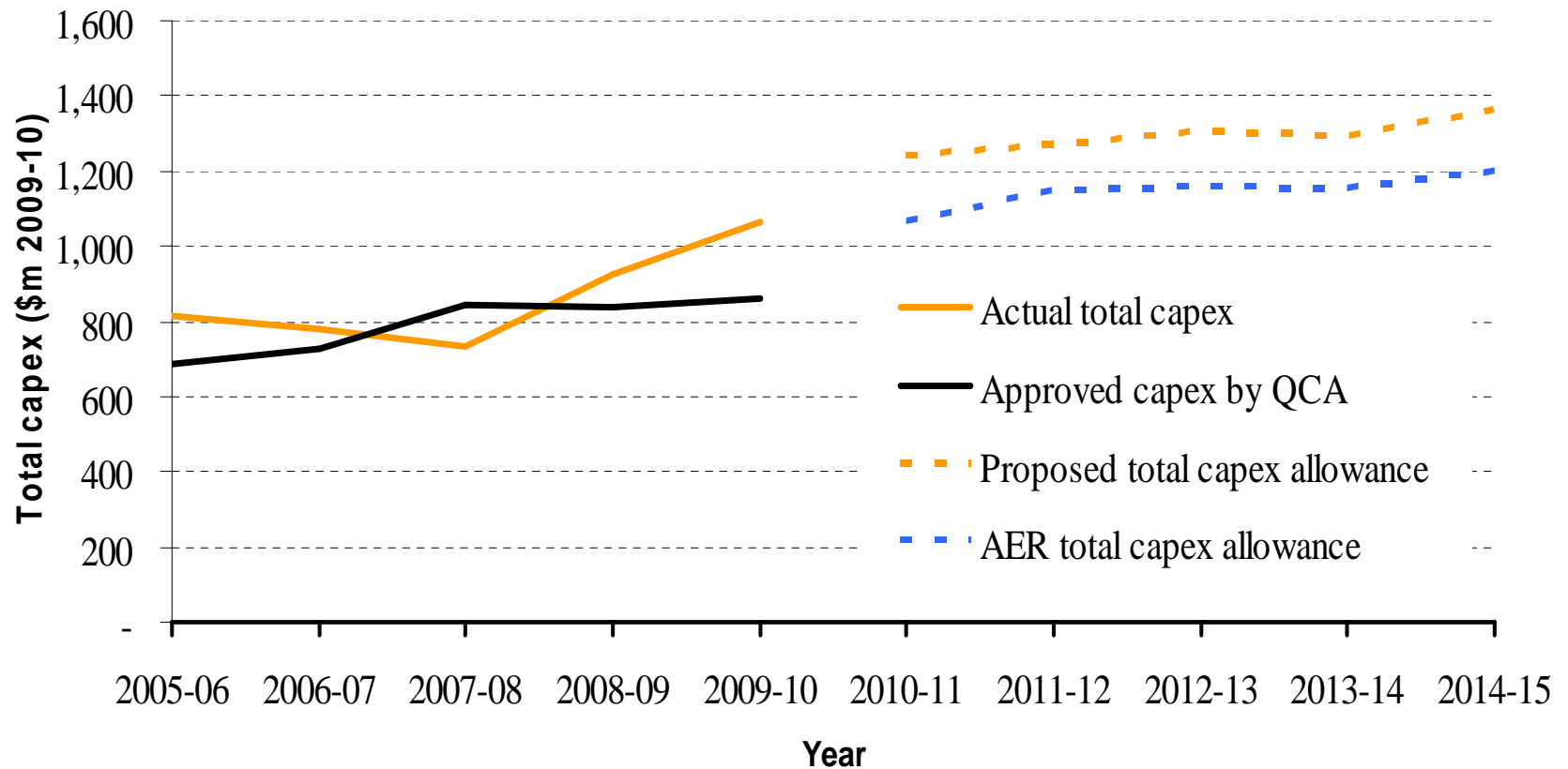
Opening RAB

- Energex proposed an opening RAB of **\$7984m** as at 1 July 2010.
 - a RAB of \$7887 million for standard control services, and
 - a RAB of \$96 million for alternative control services
- The AER accepted the opening RAB

Energex - Demand forecasts

- Energex estimated that actual MD growth over the current period was 4.9% and forecast 2.6% over the next period.
- AER engaged MMA to review Energex's forecasts:
 - MMA was concerned that Energex's spatial forecasts needed to be updated to better account for the GFC.
 - Energex's customer number forecasts were considered to be reasonable
- AER reduced Energex's MD forecasts. Growth of 3.6% is assumed but off a lower base (due to the GFC and starting point).

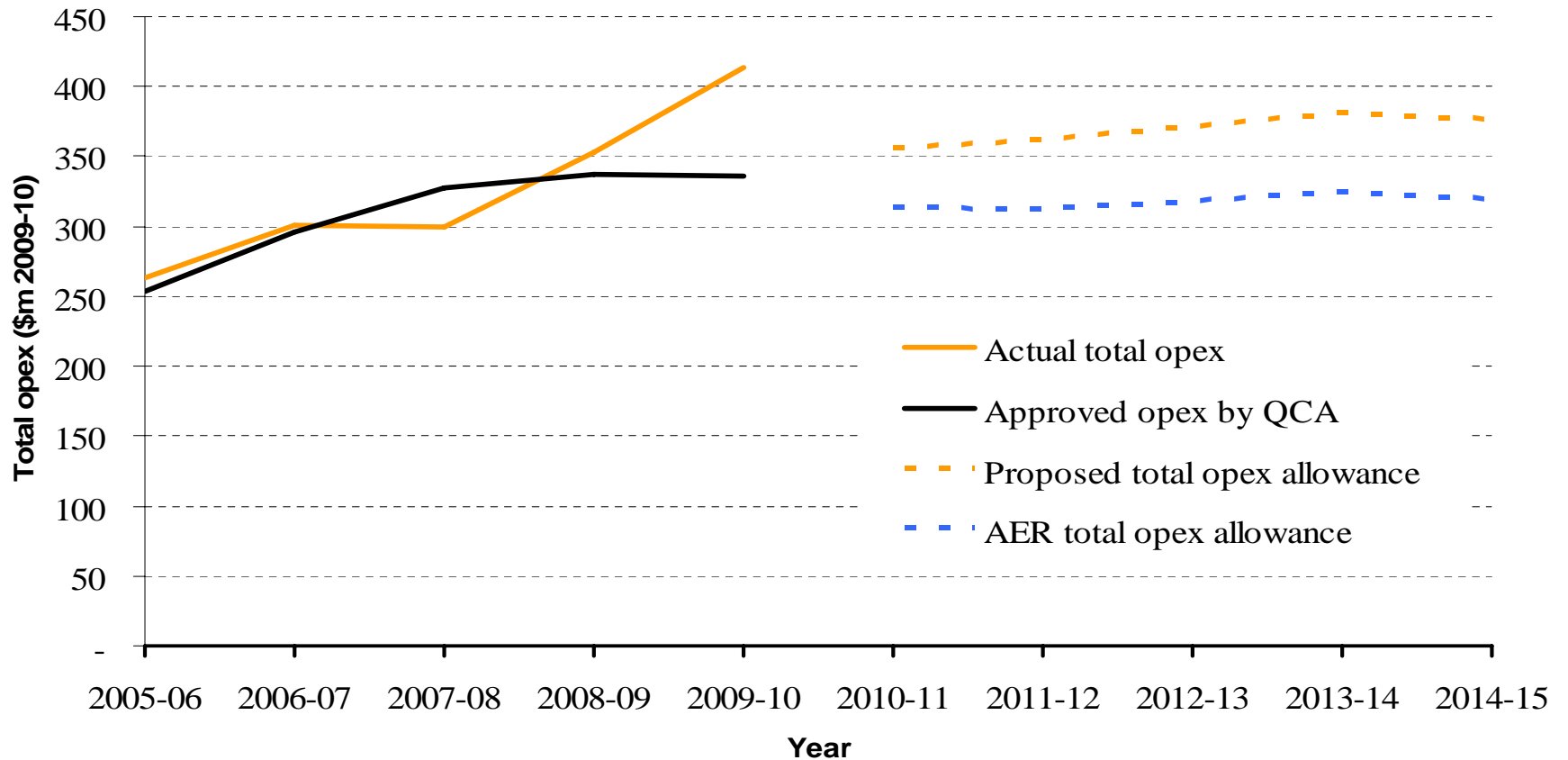
Energex capex



Capex (continued)

- Energex proposed capex of **\$6466m** (\$2009–10)
- AER reductions to proposed capex for:
 - Growth capex
 - Non system capex
 - Cost escalators
 - Indirect costs
- The AER approved capex of **\$5718m** (\$2009-10)

Energex opex



Opex (continued)

- Energex proposed opex of **\$1843m** (\$2009–10)
- Main adjustments were:
 - correct escalation of real labour and materials costs
 - equity and debt raising costs
 - self insurance
 - other support costs
- AER approved total opex of **\$1586m** (\$2009-10)

Building block revenues

AER's conclusion on Energex's expected revenues and X factors (\$m, nominal)

	2010–11	2011–12	2012–13	2013–14	2014–15
Annual expected revenues - Energex	1202.7	1336.2	1484.5	1649.2	1831.5
X Factors (%) - proposed	-25.34	-8.44	-8.44	-8.44	-8.40
Annual expected revenues - AER	1180.6	1294.2	1418.7	1555.2	1704.8
X Factors (%) - AER	-23.03	-7.00	-7.00	-7.00	-7.00

Alternative control services – Street lighting

- Previously prescribed distribution services
- AER has:
 - applied a limited building block approach
 - adjusted capex and opex allowances
 - established prices and price path for each street lighting service
- Prices are the maximum that can be charged

Alternative control services – Quoted & fee based

- AER has:
 - applied a formula based price cap approach:
$$Price = Labour + Contractor\ services + Materials + Capital\ allowances + GST$$
 - adjusted Energex's proposed formula
 - established first year prices and price path for each quoted and fee based service
- Prices are the maximum that can be charged.

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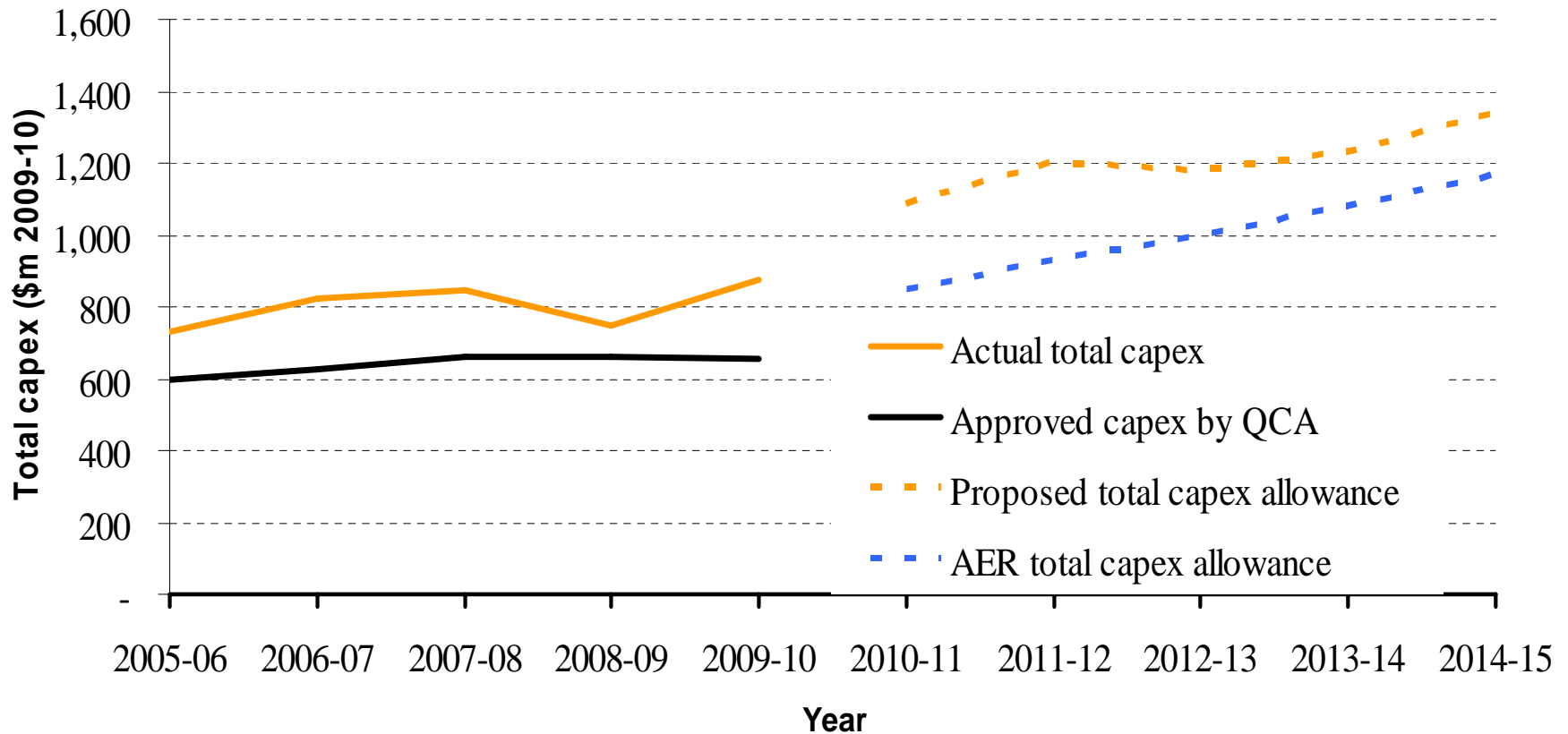
Ergon Energy - Opening RAB

- The AER determined Ergon Energy's opening RAB on 1 July 2010 to be **\$7105m**
 - reflects higher inflation rate than proposed
 - capex overspend in current period
- Network security, safety and reliability will underpin future expenditure growth, as well as demand growth

Ergon Energy - Demand forecasts

- Ergon Energy estimated MD growth of 5.1% over the current period and 3.1% over the next period.
- MMA had concerns about the methodology, including
 - lack of systematic reconciliation
 - no weather correction
 - data (starting point)
 - not responsive to changes in economic growth, population and trends in air conditioner usage.
- AER has adopted MD growth of 3.7 per cent

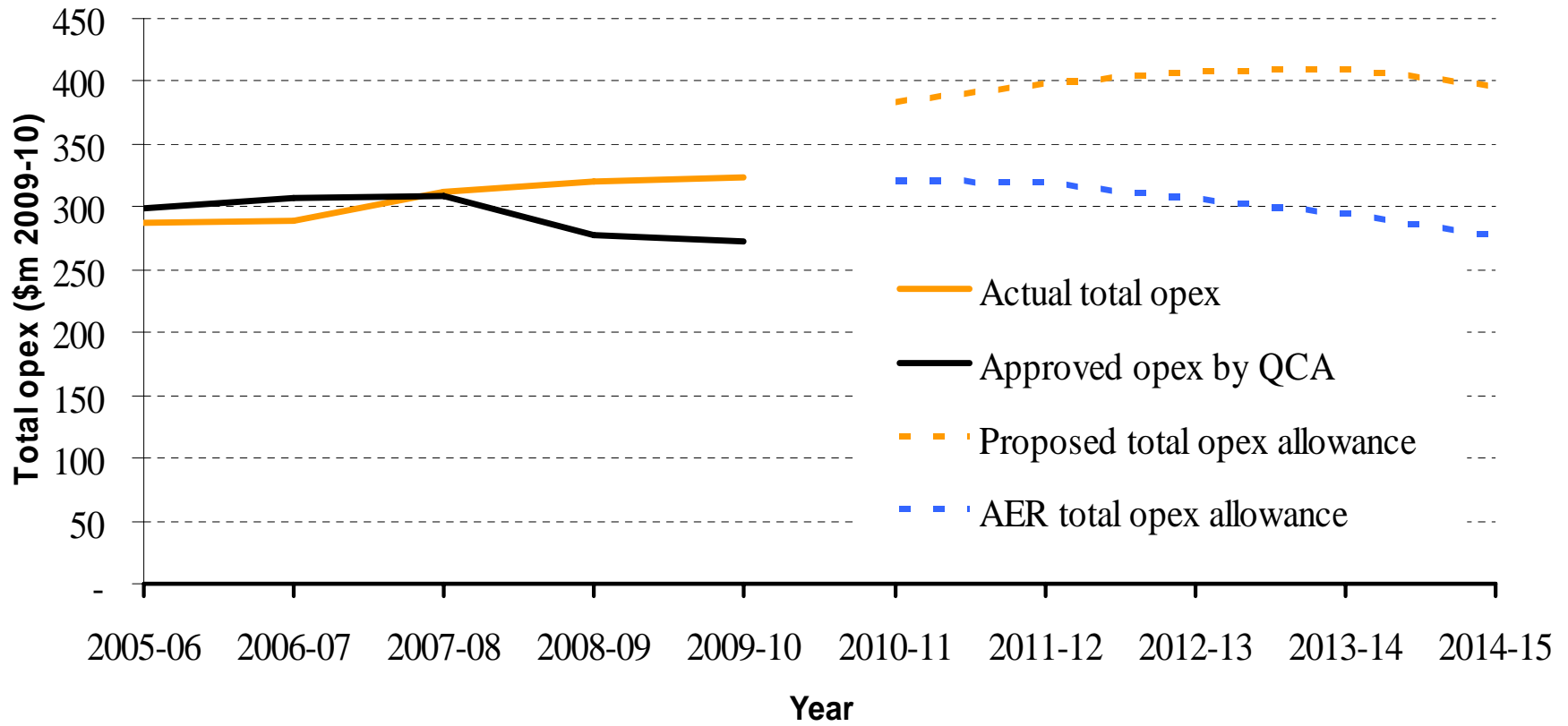
Ergon Energy capex



Ergon Energy capex (continued)

- Ergon Energy proposed capex of \$6033 million
- The AER made reductions to:
 - Growth and asset replacement capex
 - Reliability and quality improvement capex
 - Non-system capex
 - ICT, sponsorship and community engagement capex
- AER approved capex of \$5013 million

Ergon Energy opex



Ergon Energy – opex (continued)

- Ergon Energy proposed opex of \$ 1993 million
- AER reductions included those to:
 - Preventative maintenance
 - Vegetation management
 - Other opex
 - Demand management
 - Self insurance
 - Debt raising costs
 - Cost escalators
- AER approved opex of \$1514 million

Building block revenues

AER's conclusion on Ergon Energy's expected revenues and X factors (\$m, nominal)

	2010–11	2011–12	2012–13	2013–14	2014–15
Annual expected revenues - Ergon	1100.2	1213.9	1339.3	1477.6	1630.2
X Factors (%) - proposed	-27.05	-7.69	-7.69	-7.69	-7.69
Annual expected revenues - AER	1096.6	1178.5	1266.5	1361.1	1462.8
X Factors (%) - AER	-26.63	-4.90	-4.90	-4.90	-4.90

Alternative control services - Street lighting

- Ergon did not propose prices for individual street lighting services
- AER has:
 - applied a limited building block approach
 - adjusted capex and opex allowances
 - established prices and price path for each street lighting service
- Prices are the maximum that can be charged.

Alternative control services - Quoted & fee based

- Previously excluded distribution services
- AER has:
 - applied a formula based price cap approach:
$$Price = Labour + Materials + Capital\ allowances + GST$$
 - adjusted Ergon's proposed formula
 - established first year prices and price path for each quoted and fee based service
- Prices are the maximum that can be charged.

Questions

Next steps – process and timetable

- **14 January 2010** Energex and Ergon Energy to lodge revised proposals
- **16 February 2010** Submissions on draft determination close
- **30 April 2010** AER must release final decision on distribution determinations
- **21 May 2010** DNSPs submit pricing proposal
- **1 June 2010** AER approves pricing proposal
- **1 July 2010** Commencement of the next regulatory control period