

The Australian Energy Regulator

Expenditure Forecast Assessment Guidelines

Interactions with incentive frameworks



Where are we today?

20 Dec 2012

- Issues paper

12 Feb 2013

- Initial Roundtable

28 Feb 2013

- Category selection

7/8 Mar 2013

- Replacement/Demand

19/20 Mar 2013

- Connection/Customer driven capex

27 Mar 2013

- Repex/Augex models, demand forecasting

11 Apr 2013

- Opex category assessment

29 Apr 2013

- Interactions with incentive frameworks

8 May 2013

- Base-step-trend / Productivity change

16 May 2013

- Overheads, cost allocation and accounting

30 May 2013

- Expenditure setting process

The revealed cost approach

- AER's preferred, 'light handed' approach
- Opex is forecast from actual expenditure in a 'base year'
- Approach relies on the EBSS providing a continuous incentive to reduce opex
- To ensure NSP retain its share of efficiency gains/losses base opex should not be adjusted

The revealed cost approach

- Revealed cost forecast + EBSS increments/decrements = efficient opex forecast + NSP share of efficiency gains/losses
- By itself, the revealed cost opex forecast is not necessarily efficient:
 - does not reflect efficiency gains made after the 'base year' (e.g. the final year)
 - includes non-recurrent efficiency gains/losses made in the base year
- The revealed cost approach does not require these efficiency gains/losses to be identified

When should revealed costs not be used?

- If an NSP is not responding to the incentive to reduce opex then the revealed cost forecast will not be efficient
- Difficult to test—an NSP may be becoming more efficient, but it may be responding to another incentive

Proposed approach

- The revealed cost approach should be used if an NSP is found to be efficient
- However, if significant inefficiencies are identified in base opex these should be removed
- Desire to provide certainty/ clarity on this- two key questions:
 1. How will base year be assessed?
 2. When will base year be decided/ adjusted?
- If base opex is adjusted then a different efficiency sharing mechanism is required

Base year efficiency assessment

A two stage approach is proposed

Stage 1

- Stage 1 includes:
 - Economic benchmarking
 - Disaggregated category analysis
- Provides a high level assessment of efficiency
- May lead to another base year being adopted rather than further review

Base year efficiency assessment

Stage 2

- Stage 2 includes:
 - Further, more detailed, benchmarking analysis
 - Expert engineering assessment
- Further information would be sought from NSPs
- Base year expenditure would then be adjusted to ensure consistency with the opex criteria, taking into account the opex factors.

Base year efficiency assessment

- Opex category assessment – 11 April workshop
- Analysis of “direct” opex:
 - Maintenance/ inspections; Emergency response; Veg management
 - Standardised expenditure reporting categories, including detailed subcategories
 - Standard volumes/ driver measures
 - Normalisations/ NSP specific issues
- Overheads assessment – 16 May
- Economic benchmarking applications – 22 May
- (Opex “base-step-trend” – 8 May)

Timing considerations

- It is desirable to provide certainty on the assessment approach early in the determination process
- The NER requires the AER to outline in its F&A paper its proposed approach to the application of:
 - the EBSS
 - the expenditure forecast assessment guidelines
- The AER could state in its F&A paper whether it intends to use revealed costs (option 1)
- Alternatively it could outline its proposed base opex approach in its issues paper (option 2)
- Ultimately depends on when data are available

Timing considerations

Option 1

- As per NER provisions, AER would state in its F&A paper whether it intends to use the revealed cost approach or make adjustments to base opex
- This requires sufficient evidence to be available at the F&A stage
- Likely that this evidence would be in annual benchmarking reports
- First annual benchmarking report due to be published 30 September 2014, too late for upcoming resets

Timing considerations

Option 2

- The AER would state its base year approach in its issues paper, to be published 40 business days after a regulatory proposal has been submitted
- Would use whatever previous benchmarking data available at the time
- AER could also have regard to an NSP's opex forecast/ regulatory proposal information when undertaking the assessment