

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