

Key capex and opex assumptions and directors certification 2020-25

January 2019



Part of the Energy Queensland Group

Key assumptions underlying forecasts for SCS capital expenditure (capex) and operating expenditure (opex) 2020-25

As at 31 January 2019

This document contains the key capital (capex) and operating (opex) expenditure assumptions in the Regulatory Proposal for 2020-25 as well as copies of the certification of reasonableness of these assumptions by the directors of Energex and Ergon Energy, as required by the National Electricity Rules (NER).

Topic	Key Assumption	Rationale for “reasonableness”	Assurance Review	Application
Structure and ownership	Our forecasts are based on our current company structure and ownership arrangements.	Our forecasts reflect merger savings arising from our recent restructuring. A further restructuring or change of ownership could mean these savings are not achieved and may require changes to the Cost Allocation Method, and therefore the attribution or allocation of costs in our forecasts.	Not necessary, because we are assuming that our current arrangements will continue.	Capex and opex
Legislative and regulatory obligations	Our forecasts are based on our current legislative and regulatory obligations and our Distribution Authority.	Our forecasts reflect our compliance with our current obligations. Different obligations could materially change our costs.	Not necessary, because we are assuming that our current obligations will not change materially.	Capex and opex
Service classification and ring-fencing	We will apply the service classification in the Australian Energy Regulator’s (AER) Framework and Approach paper and the current ring-fencing arrangements will not change materially.	A different service classification could change the capex and opex forecasts for Standard Control Services. A change in the ring-fencing arrangements could affect how we can provide our distribution services, which could potentially change our costs.	Not necessary, because we are applying the AER’s Framework and Approach paper.	Capex and opex

Topic	Key Assumption	Rationale for “reasonableness”	Assurance Review	Application
Customer preferences and expectations	The preferences and expectations of participants revealed through our stakeholder engagement program accurately reflect those of our customers generally.	We have engaged effectively with a broad range of stakeholders on a broad range of matters. It is reasonable to expect that their preferences and expectations are representative of those of our broader customer base.	We have assessed the preferences and expectations of participants through our stakeholder engagement program and have had regard for these in preparing our Regulatory Proposal.	Capex and opex
Addressing customer concerns about affordability	Our forecasts have particular regard for the affordability of electricity supply and appropriately respond to our customers’ concerns.	The NER require us to address the concerns of consumers in developing our forecasts.	We have assessed the preferences and expectations of participants through our stakeholder engagement program. They have identified affordability as a key concern. We have had regard for this in preparing our Regulatory Proposal.	Capex and opex
Service outcomes	We will maintain, but not improve, our average system-wide service outcomes, consistent with clause 6.5.6(a) and 6.5.7(a) of the NER. We will seek to improve outcomes on our worst performing feeder consistent with our regulatory obligations.	The NER does not allow the AER to approve expenditure that improves service outcomes, unless it is required by a regulatory obligation. Our expenditure forecasts reflect this requirement.	Not necessary, because we are reflecting the requirements of the NER.	Capex and opex
Forecast capex and opex	Our capex and opex forecasts are required to deliver the safety, reliability and customer outcomes set out in our Regulatory Proposal.	Achieving our stated safety, reliability and customer outcomes depends on us delivering our proposed capex and opex program, which in turn relies upon the AER approving our forecast Annual Revenue Requirements.	Our Regulatory Proposal justifies each component of our forecast Annual Revenue Requirements, including our forecast capex and opex.	Capex and opex

Topic	Key Assumption	Rationale for “reasonableness”	Assurance Review	Application
Demand	Our base case network peak demand forecast provides an appropriate basis for our network augmentation forecast.	Our peak demand and energy forecasts have been prepared consistent with good industry practice, with independent input and verification. They provide the best view of “expected demand” for the purposes of clauses 6.5.6(a)(1) and 6.5.7(a)(1) of the NER.	We engaged ACIL Allen to provide updated independent advice and recommendations on our forecasting methodology based on Industry best practice for system maximum demand and energy forecasts.	Capex
Customer numbers	Our base case customer number forecast provides an appropriate approach for our connections capex forecast and the customer numbers component of our opex rate of change.	Our customer number forecasts have been prepared using independently verified methodology and recommendations.	We engaged ACIL Allen to provide updated independent advice and recommendations on our forecasting methodology based on Industry best practice for customer number forecasts.	Capex and opex
Cost allocation	Our Cost Allocation Method provides an appropriate basis for attributing and allocating costs to, and between, our distribution services.	Our Cost Allocation Method has been approved by the AER and complies with the requirements of clause 6.15 of the NER and the AER’s Cost Allocation Guideline.	Not necessary, because our Cost Allocation Method will be approved by the AER. We have applied this Method in forecasting our Annual Revenue Requirements and capex and opex.	Capex and opex
Unit rates/standard estimates	Unit rates/standard estimates are used in the development of our bottom up forecasts where appropriate.	Our unit rates/standard estimates provide the best view of the actual costs that we will incur.	We engaged GHD to provide advice on, and to review, our unit rates to ensure these are reasonable and reflect prudent and efficient operations.	Capex

Topic	Key Assumption	Rationale for “reasonableness”	Assurance Review	Application
Real cost escalations for capex	Our real cost escalations used for our capex forecasts are reasonable and reflect prudent and efficient costs.	These escalations have been prepared consistent with good industry practice, with independent input and verification. They provide the best view of the actual costs that we will incur after the application of our objectives.	We engaged BIS Oxford Economics to provide advice and recommendations regarding appropriate escalation rates, and used the average of these and those calculated by the Australian Energy Regulator’s consultant Deloitte.	Capex
Inflation	Our forecast inflation is reasonable and reflects the inflation-related costs that we will incur.	Our inflation forecast reflects the AER’s preferred approach to forecasting inflation, by taking the geometric mean of: <ul style="list-style-type: none"> • two years of forecast inflation published by the RBA in its most recent statement of monetary policy, and • eight years of forecast inflation at the midpoint of the RBA’s inflation 2–3% target, of 2.5%. 	Not necessary, because we are applying the AER’s preferred approach to estimating forecast inflation.	Capex and opex
Current period capex	We will deliver our forecast capex in the remainder of the current period, which will provide an appropriate basis for our capex program in the next period. Our forecast capex is less than our capex allowance for the current regulatory period.	What we spend in the next period in part depends on what we spend in the current period.	Not necessary, because this reflects our assumption about what will be spent in the remainder of the current regulatory control period.	Capex

Topic	Key Assumption	Rationale for “reasonableness”	Assurance Review	Application
New Connection Policy	We will apply our new Connection Policy.	Our Connection Policy has changed. The Connection Capex forecast reflects this new policy.	We have assessed the preferences and expectations of participants through our stakeholder engagement program and have had regard for these in preparing new Connection Policy.	Capex
Opex base year	The financial year 2018-19 is an appropriate base year for our opex forecast and, subject to our proposed adjustments, is reasonably representative of our recurrent prudent and efficient future opex requirements.	This reflects the AER’s preferred approach to forecasting opex.	Not necessary, but we have undertaken benchmarking and other assessments and can demonstrate the efficiency of our 2018-19 base year.	Opex
Opex trend assumptions	Our forecast changes in input costs, output growth and productivity are reasonable and appropriately reflect the trend in our future opex, given our (adjusted) opex base year.	We are applying the AER’s preferred framework to forecast these trends.	Not necessary, because we used the AER’s preferred framework to forecast each component of the opex trend.	Opex
Cost pass throughs and contingent projects	The AER will approve our nominated pass through events and we will not have any contingent projects.	We have nominated several pass through events (in addition to the prescribed pass through events in the NER) and have not proposed any contingent projects. If the AER decides not to accept our nominated events, and/or decides to create one or more contingent projects, then our capex and opex forecasts would potentially need to change.	Not necessary, because any change in our capex and opex forecasts would depend on which (if any) nominated events the AER rejects and what (if any) contingent project it determines.	Capex and opex

Energex

The Board **APPROVED** and **CERTIFIED** that:

- a) in accordance with schedule 6.1.1 (5) of the National Electricity Rules, the key assumptions that underlie the capital expenditure forecasts as set out in this document are reasonable
- b) in accordance with schedule 6.1.2 (6) of the National Electricity Rules, the key assumptions that underlie the operating expenditure forecasts as set out in this document are reasonable


.....
Signed: Company Secretary


.....
Dated

Ergon Energy

The Board **APPROVED** and **CERTIFIED** that:

- a) in accordance with schedule 6.1.1 (5) of the National Electricity Rules, the key assumptions that underlie the capital expenditure forecasts as set out in this document are reasonable
- b) in accordance with schedule 6.1.2 (6) of the National Electricity Rules, the key assumptions that underlie the operating expenditure forecasts as set out in this document are reasonable


.....
Signed: Company Secretary


.....
Dated