SP Ausnet Transmission pre-determination conference: Revenue Reset 2015 to 2017

Preliminary analysis and commentary on behalf of the Energy Users Association of Australia

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Opex – summary of actuals, proposals and DD

- SP Actuals 2008 to 2014 circa $82m p.a
- SP Ausnet proposed circa $100m p.a.
- AER DD 2015 to 2017 circa $80m p.a.
- Energy users to pay ~ $33m in EBSS because SP Ausnet beat allowances 2008 to 2014.
- After accounting for capitalisation of equity raising costs, AER DD 2015 to 2017 ~ equal to SP 2008 to 2014 actuals.

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Opex – initial comments

1. Judicious use of “revealed costs” important. Need to take account of the specific case.

2. In case of SP Ausnet, strong case for reliance to be placed on revealed costs, because of significance of EBSS in SP management contract (i.e. very strong managerial incentives to reduce opex below allowance in order to maximise EBSS payments and hence management incentive payments).

3. We share AER’s concerns about paying for the same thing twice (to be precise, at least twice!). Hence share AER’s skepticism about SP’s hybrid approach (i.e. revealed costs for some, but then step changes for the rest, strategic rebadging etc.). We agree with the AER’s analysis that this will disproportionately reward SP for opex reductions in 2008 to 2014.

4. AEMO’s AIS: We definitely do not support “penalty” based AEMO approach (whose penalties payments are passed through to users).Not clear to us why AIS is needed. If AIS is to be applied, scheme should be revenue neutral on expected service outcomes.

5.Capitalisation of equity raising costs: $53.4m – rather a large adjustment to the RAB. Currently reviewing the calculations.

6. In the final count, AER decision reflects no real reduction in opex from 2008 to 2014 actuals. Why is SP Ausnet not expected to make on-going productivity improvements at least at the rate of the rest of the Australian economy (i.e. circa 2% p.a.), not least considering massive capex program?

Cost of capital – initial comments

1. Accept that AER has limited discretion beyond choice of averaging period and calculation of DRP.

2. AER DD: DRP of 3%. Implies cost of debt of 6.54%

3. Evidence of actual SP debt costs suggests big gap. E.g. in Feb 2013 SP Ausnet issued AUD 7 and 10 year bonds of $300m and $100m priced as 175 + swap and 160 + swap respectively. Allowing 60 bp to convert from Swap to 10 year, and taking account of Feb swap of circa 2.8% provides comparative debt costs of 5.15% (for 10 year bond) and 5% for (for 7 year bond). A big gap between AER DD (6.54%) and evidence of SP Ausnet actual debt costs.

4. We accept that ACT (AcompT3) suggested AER needed to develop new approach and that this would take time (and consultation). But we suggest that there is more that the AER can do, even within the current approach, to narrow the gap between evidence of actual debt costs and AER's methodology (for example why use GPT for bond pairs in extrapolations?).

Capex

• AER DD 2015 to 2018:	~$396m
• SP Proposal 2015 to 2018 (excluding West Melbourne):	~$458m
• SP Actual 2008 to 2014 (per year):	~$132m
• SP allowed 2008 to 2014:	~$188m

- SP has had the benefit of depreciation and returns on $120m of capex that has not been spent
- AER allowance per year for 2015 to 2018 (excluding West Melb. and possible increases to Richmond) about the same per year as actuals for 2008 to 2014.

Main AER reductions

• “Strategic IT”	-$17m
• Cost forecasting bias and Fisherman’s bend	-$20m
• Prudency	-$24m
• Real cost escalators	-$18m

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Capex – initial comments

- Method for prudency adjustment inevitably debatable. But we support AER’s fundamental arguments – SP Ausnet has an incentive to overstate its reasonable needs.

- “Strategic“ IT: we agree the case has not been made.

- Even excluding foreseen increases to allowances for Richmond and West Melbourne, AER allowance is no lower than 2008 to 2014 actuals. But demand growth substantially lower than historic forecasts. Has opportunity to defer investment been adequately assessed?

- Taken together, depending on allowances for Richmond and West Melbourne, AER final decision may turn out to be comparable to 2008-2014 decision, which was substantially above actuals. We are concerned that the significant gap between allowed and actual should not repeated and call on the AER to revisit scope for deferral across full program.

EBSS, Contingent projects and West Melbourne Terminal Station

- **EBSS:** yes five year carry-over, not six. Why should period of carry-over correspond to duration of regulatory period (5 years will continue to apply for coming 3 year period)

- **Contingent projects**: not clear why SP Ausnet proposed failure of either H1 or H2 transformer banks at South Morang. Can't comment on the other two contingent projects because analysis not public.

- **West Melbourne**: The last minute change is a little concerning. Was this not anticipated? For a project that had been anticipated and costed, why is the compulsory acquisition such a last minute surprise? We are concerned about the amount of time available to scrutinise alternative proposals that SP Ausnet may provide in its revised proposal.

STPIS

- Network capability projects allow another $13m to SP for 22 projects (on top of opex and capex allowances?) SP Ausnet had only proposed $4.8m for 15 projects. What is going on here? Why has AEMO produced a project ranking? If this projects relate to network constraints, there is the possibility of double-dipping (SP Ausnet being paid to reduce constraints but then also getting very substantial (2% of MAR per year) a market impact incentive payment to do the same thing.)

- Not clear how AER will assess performance against network capability projects

- Not clear why SP Ausnet should receive any positive incentive payment relating to funded Network Capability Projects

- We support AER's decision to disallow adjustment for loss of supply events relating to 2014-17 capital works.

Pass-throughs

- Agree with “major” as qualifying descriptor for natural disaster event.
- “Insurance cap event”: not yet clear on the difference between SP Ausnet’s proposals and AER’s DD