Better Regulation

**Expenditure forecasting assessment roundtable**

Date: Tuesday, 12 February 2013, 13:00 to 16:30

Locations: Level 35 The Tower, 360 Elizabeth Street, Melbourne Central

 Level 20, 175 Pitt Street, Sydney

Roundtable chair: Andrew Reeves

**Agenda:**

13:00 Registration

13:15 Introductions

13:30 Discussion of the overall program and AER’s objectives

14:00 Recap of issues paper and opportunity for stakeholder feedback

14:45 Break

15:00 Proposed forward work program (See attached)

16:00 Future meeting logistics

16:15 AOB

**Attachment: Proposed working group forward agenda**

This attachment outlines our proposal for packaging and sequencing consultation on the issues arising in the preparation of the expenditure assessment guidelines, benchmarking reports, related information reporting instruments and network determinations.

Overall we anticipate a consultation program focused on extending the existing methods around category or activity based assessments used in recent determinations, including as part of a nationally consistent approach. This will be supplemented by the use of new, holistic benchmarking techniques. In doing so we will be exploring the relationships with incentive arrangements and our current reliance on the principles of “revealed cost” when setting efficient forecast expenditure allowances.

As per the presentation of matters in our issues paper, we anticipate the need to discuss several key overarching issues in addition to consultation on more detailed assessment techniques for expenditure categories and for economic benchmarking. These are outlined in more detail below.

Board member participation in working group meetings is expected for meetings where broader framework issues and matters of high priority are discussed. Attendance will be subject to the timing of specific meetings and Board member availability.

***Category analysis meetings***

These meetings will cover our intended approach to the assessment of expenditure categories that are defined and separated according to main activities and drivers, such as asset replacement and routine maintenance.

Our proposed sequencing/ packaging of working group meetings around category based assessment involves addressing the following general questions:

* What factors must the AER consider when determining forecast expenditure allowances?
* How are these factors to be considered? This may involve both general principles of consideration, as well as more detailed methods for manipulating data.
* What datasets should be collected from NSPs in order to complete this consideration? Includes particular expenditure data, asset data, demand data, anything else that is required to assess expenditure in accordance with the NER. Precise definitions must be created, and boundary issues between categories resolved.

This has been presented below in 4 general phases:

1. The general task of assessment, identification of categories and considerations relevant to each.
2. Detailed examination of each category of expenditure and supporting data to aid resolution of further definitional issues.
3. Generic matters and those not amenable to assessment within categories.
4. Detailed examination of supporting assessment techniques.

Prior to each working group meeting we expect to circulate our detailed position/ thinking on the topics to be discussed based on any pre-existing methods used to assess expenditure categories and our understanding of NSP operating environments. We expect this material and workshop agendas will reflect stakeholder responses to our issues paper to be received by 15 March.

While we propose to address issues in a particular sequence, issues arising from the working group meetings may require us to revisit matters that have been previously considered. This may require further iterations and follow up material to be circulated to working group attendees.

We do not propose to hold workshops for the following given time constraints and as the approaches to forecasting/ assessment some of these matters are somewhat standardised:

* debt and equity raising costs
* real input price escalators
* allowances for cost estimation risks, and
* related party margins

Subject to stakeholder views it may be sufficient to develop draft guidelines on the basis of written submissions on these matters as well as hold bilateral meetings with affected stakeholders outside the working group process.

***Meetings on economic benchmarking techniques***

Economic benchmarking techniques refer to methods that employ economic theory on the behaviour of firms in order to estimate relative efficiency and how this changes over time. The methods also provide a framework for decomposing the various types of efficiency affecting NSPs.

Consistent with the holistic approach to selecting economic benchmarking techniques forwarded in our issues paper, we intend that the workshops on economic benchmarking predominately focus on data requirements. The workshops will cover high level issues and we will issue questions to stakeholders on matters of detail where required.

The economic benchmarking work program can be separated into three phases:

1. Identification of inputs, outputs, and environmental variables
2. Measurement and data requirements of the holistic approach
3. Implementation of economic benchmarking techniques in assessing NSP expenditure proposals

These phases can be further broken down into separate workshops. We propose to have separate workshops for transmission and distribution businesses where the subject matter is industry specific.

It is difficult to be definitive about number of meetings needed in the second phase of workshops; this will in part hinge on the inputs, outputs and environmental factors that are identified in the first phase. However, we have flexibility to hold additional workshops and change the scope of the matters to be canvassed in those workshops subsequent to the first phase, if needed.

After the first two phases of workshops, a final workshop will be held on:

* how economic benchmarking techniques will be selected for each expenditure review; and
* how economic benchmarking techniques will be applied in forming a view about a NSP’s proposed expenditure.

***Meeting on overarching/ general issues***

Following consideration of detailed assessment issues, we propose to consider general matters including:

* The specific content of the guidelines (and hence matters left for framework and approach processes), for example, whether the guidelines simply outline techniques and general data requirements, or go further to specify how each technique would be used in setting allowances, and whether the guidelines should include principles to guide the use of techniques for the AER/ NSPs.
* Various implementation issues, including how RIN/RIO implications should be managed and the related timing of benchmarking reports and network determinations.
* Links with other guidelines, particularly expenditure incentives and cost allocation, as well as decisions in the F&A process such as the classification of services which affect the scope of expenditure assessments.
* Our suggested “first pass” assessment approach.
* Reconciliation between top down and bottom up assessment techniques.

**Suggested working group meetings and discussion topics – category analysis**

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|  | **Phase 1 - Category areas** | **Phase 2 – category data requirements** | **Phase 3 - Further issues** | **Phase 4 - Assessment techniques** |
| *General theme* | *Bed down the factors that the AER must consider when determining forecast expenditure.**Determine categories in which expenditure must be forecast / modelled and the factors / issues relevant to each area.* | *Bed down the main approach to categorising the activities undertaken by NSPs (and the expenditure incurred in doing them). Derive from this initial categorisation appropriate measures of explanatory variables.* | *Resolving other regulatory issues that may affect the makeup of datasets but are not related to main categories of NSP expenditure.* | *Discuss the complex manipulations to the datasets that are likely to occur as part of the assessment process (simple manipulations may be excluded).* |
| First meeting of phase | Workshop 1.1 - Category selection* Objectives and principles for selection
* General definitional issues
 | Workshop 2.1 - Capex 1* Replacement
* Demand driven (distribution)
* Demand driven (transmission)
* Other
 | Workshop 3.1* Use of actual data and incentives
* Base step and trend approach
* Productivity & technological change
 | Workshop 4.1* Repex model
* Augex model
* Demand forecasting methods
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| Second meeting of phase | N/A | Workshop 2.2 - Capex 2* New connections (distribution)
* New connections (transmission)
* Customer requested other (fee-based & quoted)
 | Workshop 3.2* Reconciliation issues (statutory accounts)
* Cost allocation
* Capitalisation policies
 | N/A  |
| Third meeting of phase | N/A | Workshop 2.3 - Opex* Maintenance (proactive and reactive)
* Emergency
* Vegetation maintenance
* Other expenditures
 | N/A  | N/A |
| Fourth meeting of phase | N/A | Workshop 2.4 - Overheads* Direct versus indirect expenditures
* Treatment of overheads and non-network expenditure
 | N/A  | N/A |

**Suggested working group meetings and discussion topics – economic benchmarking techniques**

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|  | **Phase 1 - Identification of inputs, outputs, and environmental variables** | **Phase 2 - data requirements** | **Phase 3 - Implementation of economic benchmarking techniques**  |
| *General theme* | *Developing an “in principle” position on inputs, outputs and environmental factors.*  | *Consideration of data requirements and measurement issues* | *EFA guideline content and specifications* |
| First meeting of phase | Workshop 1.1Network outputs ­­- distribution* Output and environmental factor criteria
* Output specifications and weightings - DNSPs
* Environmental factors
 | Workshop 2.1Measurement of outputs and environmental factors – distribution* Weighting of outputs and environmental factors
 | Workshop 3.1Prescription in EFA guideline* The principles for the selection of economic benchmarking techniques
* Application of economic benchmarking and the review of expenditure forecasts
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| Second meeting of phase | Workshop 1.2Network outputs ­­- transmission* Output and environmental factor criteria
* Output specifications
* Environmental factors
 | Workshop 2.2Measurement of outputs and environmental factors - transmission* Weighting of outputs and environmental factors
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| Third meeting of phase | Workshop 1.3Network inputs (transmission and distribution)* Criteria for selecting inputs
* The split of inputs into “assets” and “operation and maintenance”
* Physical vs value measures for inputs
 | Workshop 2.3Network Input measurement (distribution and transmission) * Deriving the value of capital stock
* Weighting of inputs
* Any overlap between inputs and environmental factors
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**Suggested detailed timetable**

The timetable below is indicative only and has been prepared for the purposes of consideration by stakeholders. A finalised workshop schedule will be circulated following the 12 February meeting. Dates may be subject to further changes pending meeting room availability.

Discussion papers and other materials will be sent to interested stakeholders before each workshop.

For the category analysis working group, discussion papers will be sent to interested stakeholders approximately one week prior to the relevant workshop. Feedback from interested stakeholders will be informally sought, which will be used to expedite and guide the discussion of issues during the workshops.

For the economic benchmarking working group, two sets of discussion papers will be developed and published. The first set of papers will be published prior to the first phase of workshops, and will address issues relevant to all of the workshops of the first phase. Similarly, the second set of discussion papers will be published prior to the second phase of workshops. We will seek submissions on these discussion papers prior to the beginning of each phase.

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| **Date** | **General guideline consultation** | **Economic benchmarking techniques workstream** | **Category analysis workstream** |
| 12 Feb 2013 | Initiation roundtable |  |  |
| 26 Feb 2013 |  |  | 1.1 – Category selection |
| 7 Mar 2013 |  |  | 2.1 – Replacement and demand driven augmentation |
| 12 Mar 2013 |  |  1.1 – Network outputs (Dx) |  |
| 14 Mar 2013 |  |  1.2 – Network outputs (Tx) |  |
| 19 Mar 2013 |  |  1.3 (morning) – Network inputs | 2.2 (afternoon) – Connections and customer driven works  |
| 26 Mar 2013 |  |  |  2.3 – Opex |
| 11 Apr 2013 |  |  |  2.4 – Overheads |
| 23 Apr 2013 |  |  |  3.1 – reliance on actual data, base step and trends, productivity change |
| 30 Apr 2013 |  |  2.1 – Measurement of outputs and environmental factors (Dx) |  |
| 2 May 2013 |  |  2.2 – Measurement of outputs and environmental factors (Tx) |  |
| 7 May 2013 |  |  2.3 (morning) – Network input measurement |  3.2 (afternoon) – statutory accounting issues, cost allocation, capitalisation policies and reporting |
| 16 May 2013 |  |  |  4.1 – repex model, augex model, demand forecasting |
| 23 May 2013 |  |  3.1 – Prescription in the EFA guideline |  |
| 28 May 2013 | General issues workshop – RIN/RIO implications, first pass assessment, links with other guidelines, reconciliation of assessment methods |  |  |
| 9 Aug 2013 | Publish draft guides |  |  |