

Further information on the Victorian electricity transmission draft decision

The cost of capital for the draft decision is 7.43 per cent compared to 9.76 per cent in the current regulatory period. The lower cost of capital reduces average annual revenue requirements compared to the past and therefore going forward should help reduce electricity prices for customers.

To determine the cost of capital, the transitional rules requires the AER to apply the weighted average cost of capital (WACC) parameters published in the 2009 statement of regulatory intent for WACC. Therefore, the draft decision does not incorporate the current thinking which is set out in the Rate of Return Draft Guideline published under the AER's Better Regulation program. In this transmission decision, the AER is required to only consider the appropriate time period used to capture the current market conditions for the risk free rate and cost of debt. These will be updated for the final decision using the agreed time period.

The AER has allowed sufficient capex to replace ageing assets. Of the two proposed large projects to rebuild the substations that supply the Melbourne central business district, we have approved capex for the Richmond substation. However, the replacement of the West Melbourne substation assets was not considered in determining the total capex allowance because of the high level of uncertainty about timing and costs that has recently arisen. In mid-July, the Linking Melbourne Authority indicated that part of the substation site could be subject to compulsory acquisition. SP AusNet's proposed capex was \$564 million whereas our substitute is \$396 million.

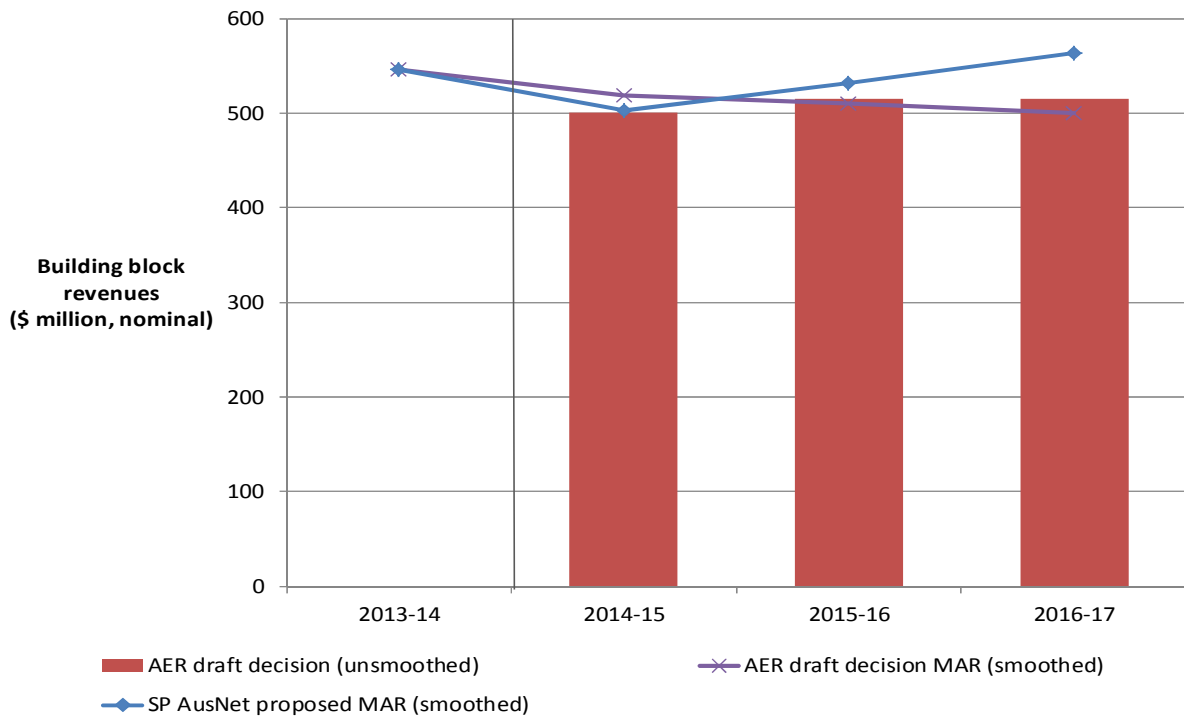
Sufficient operating expenditure has been approved for SP AusNet to continue managing the transmission network efficiently in the long term interests of consumers.

The AER had a number of concerns with the proposed opex forecast including the methodology used by SP AusNet. We are not satisfied that SP AusNet's methodology results in an efficient and prudent opex forecast. SP AusNet's proposed opex included allowances for works that customers paid for during the current regulatory period. Further, we are not satisfied that external drivers influence a number of the proposed cost increases that were included in SP AusNet's opex forecast. SP AusNet's proposed opex was \$607 million whereas our substitute is \$543 million.

Additionally, one of the key features of our regulatory framework is the incentive embedded in it for regulated businesses to make commercial decisions in managing their networks. In relation to operating expenditure, we incentivise regulated businesses to continuously exert effort to achieve efficiencies. The AER rewards efficient businesses by allowing them to keep a share of the efficiency gains for a period of time. This approach is underpinned by a mechanism that fairly shares the reward with consumers. SP AusNet's opex forecasting methodology does not account for the interrelationship between forecast and the incentive framework and therefore do not share the rewards fairly with consumers.

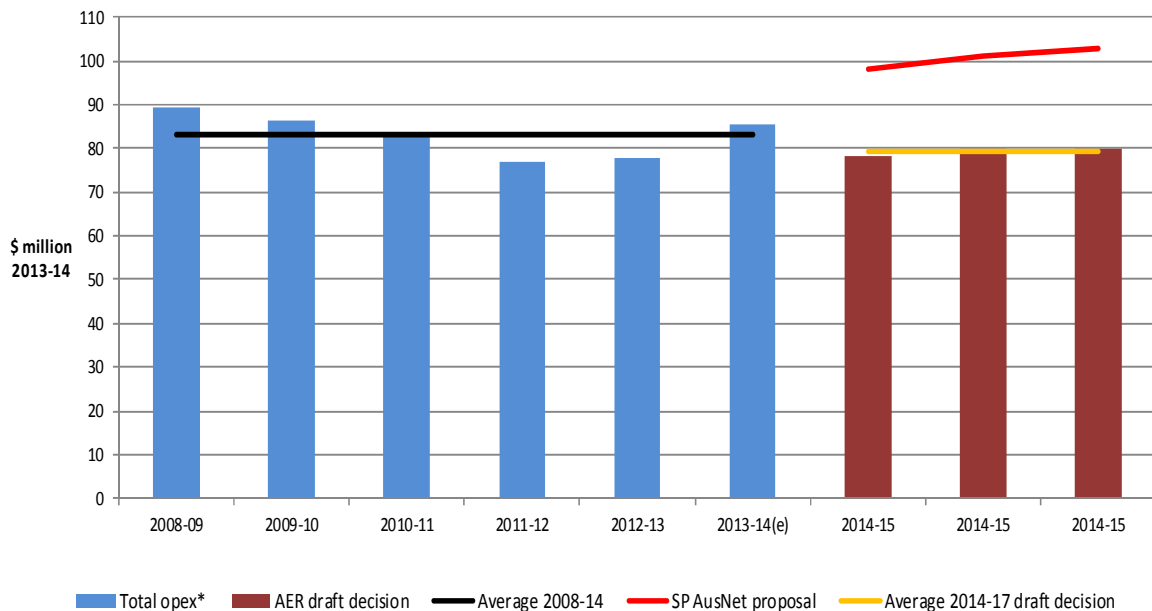
Figure 1 graphically presents SP AusNet's proposed revenue requirement and the draft decision. The AER sets the maximum revenue that SP AusNet is able to recover annually. We do not set their transmission prices. However, based on the draft decision revenues for SP AusNet, the revenue proportion for Murraylink and AEMO's latest forecast annual energy delivered in Victoria, we estimate that average transmission charges in Victoria will reduce by around 7 per cent per annum over the next regulatory period.

Figure 1 AER draft decision and SP AusNet's proposed maximum allowed revenue



One of the primary drivers of our reduction to SP AusNet's proposed revenue is the opex allowance approved under this draft decision. Figure 2 graphically presents our draft decision allowance. It also shows SP AusNet's past and proposed total opex.

Figure 2 AER's draft decision, total* opex (\$ million, 2013–14)



Note: *Land and easement tax is excluded from non-controllable opex in this chart because, positive or negative variation (>1% MAR) between the actual tax paid and the forecast approved by us will be recovered/reimbursed via an annual recovery mechanism; (e) 2013–14 data is a budget estimate.