
AER Forum

Draft Decision on Powerlink application

14 December 2011

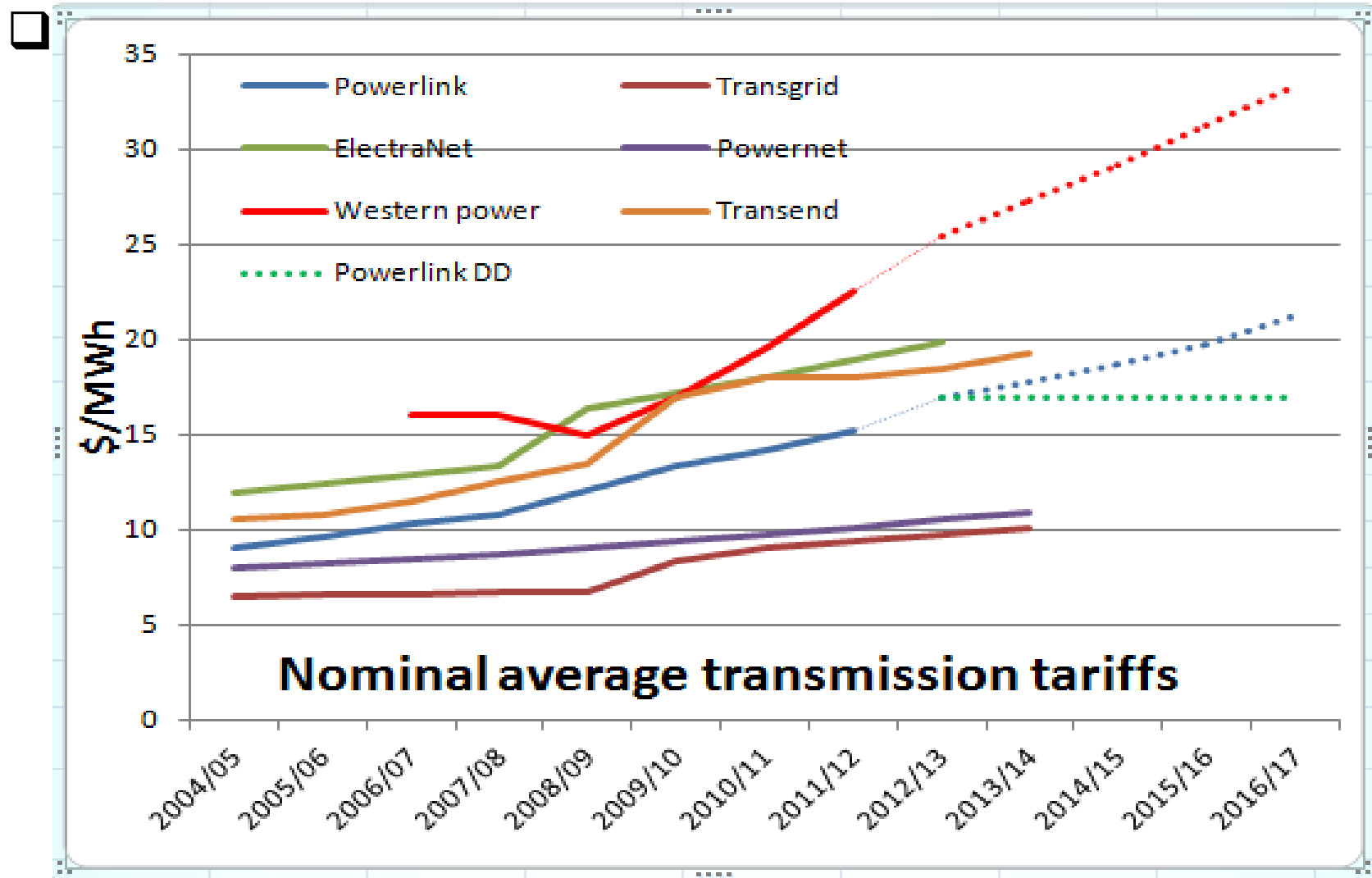
Energy Users Group in Queensland

Presentation by David Headberry, Public Officer, MEU

About the Energy Consumers Group in Qld

- It represents the views of a number of large electricity users in Queensland
 - It is highly focused on key issues that make a difference for large energy consumers
 - The Group's concerns are with the cost, quality, reliability and sustainability of energy supplies essential for the continuing operations of the members who have invested \$ billions to establish and maintain their facilities in Queensland
 - As a general view, the performance of Powerlink in providing reliable supplies of electricity is seen as good
 - In relation to the Powerlink application, the Group's prime focus is on ensuring consumers only incur efficient costs in transport of electricity with the same service standards
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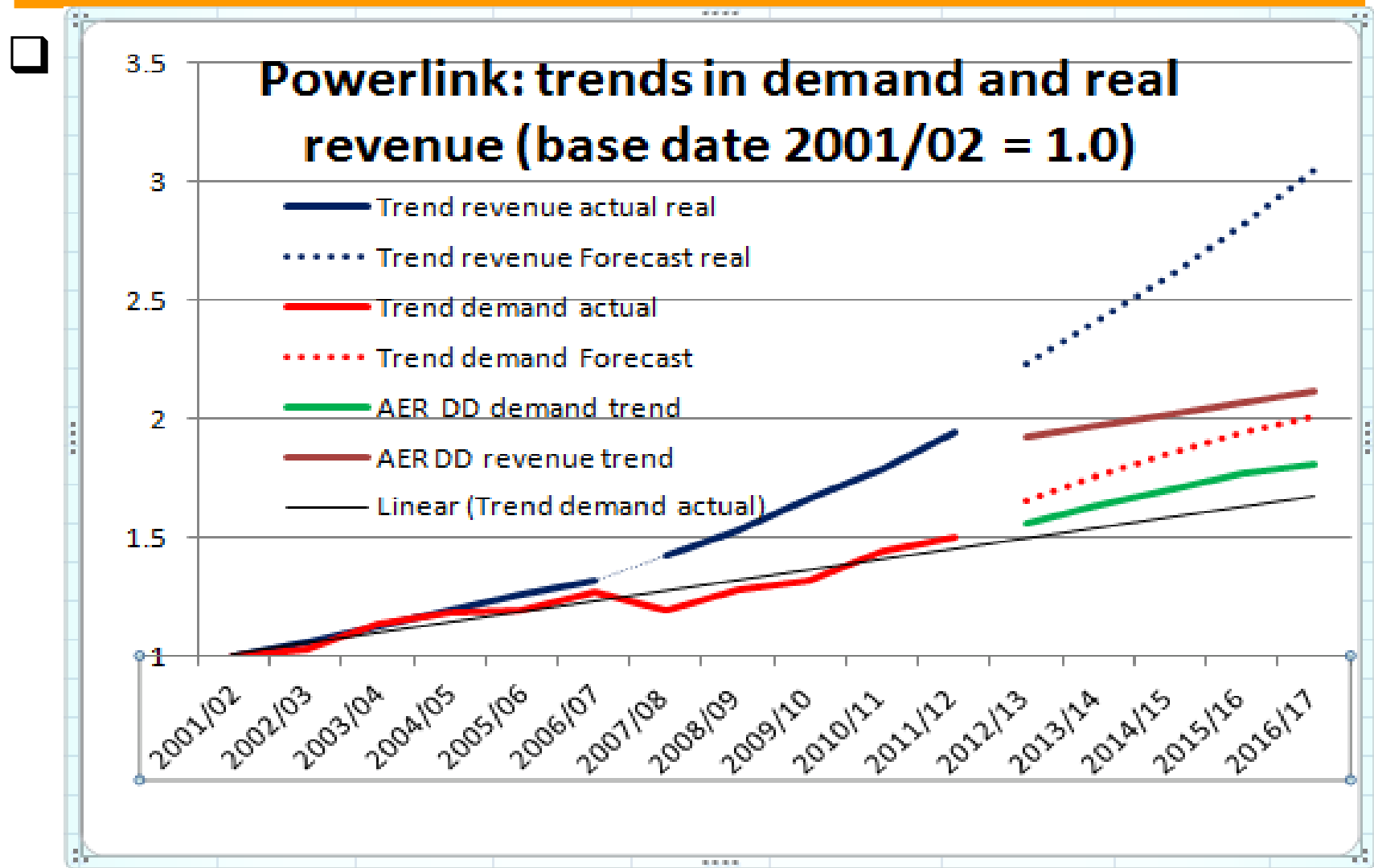
Powerlink prices in context with other TNSPs



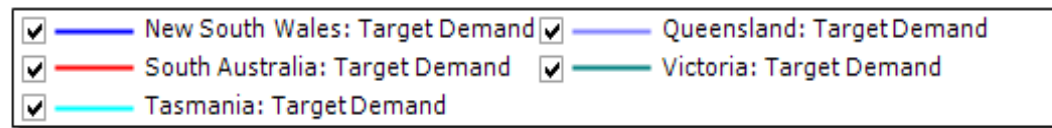
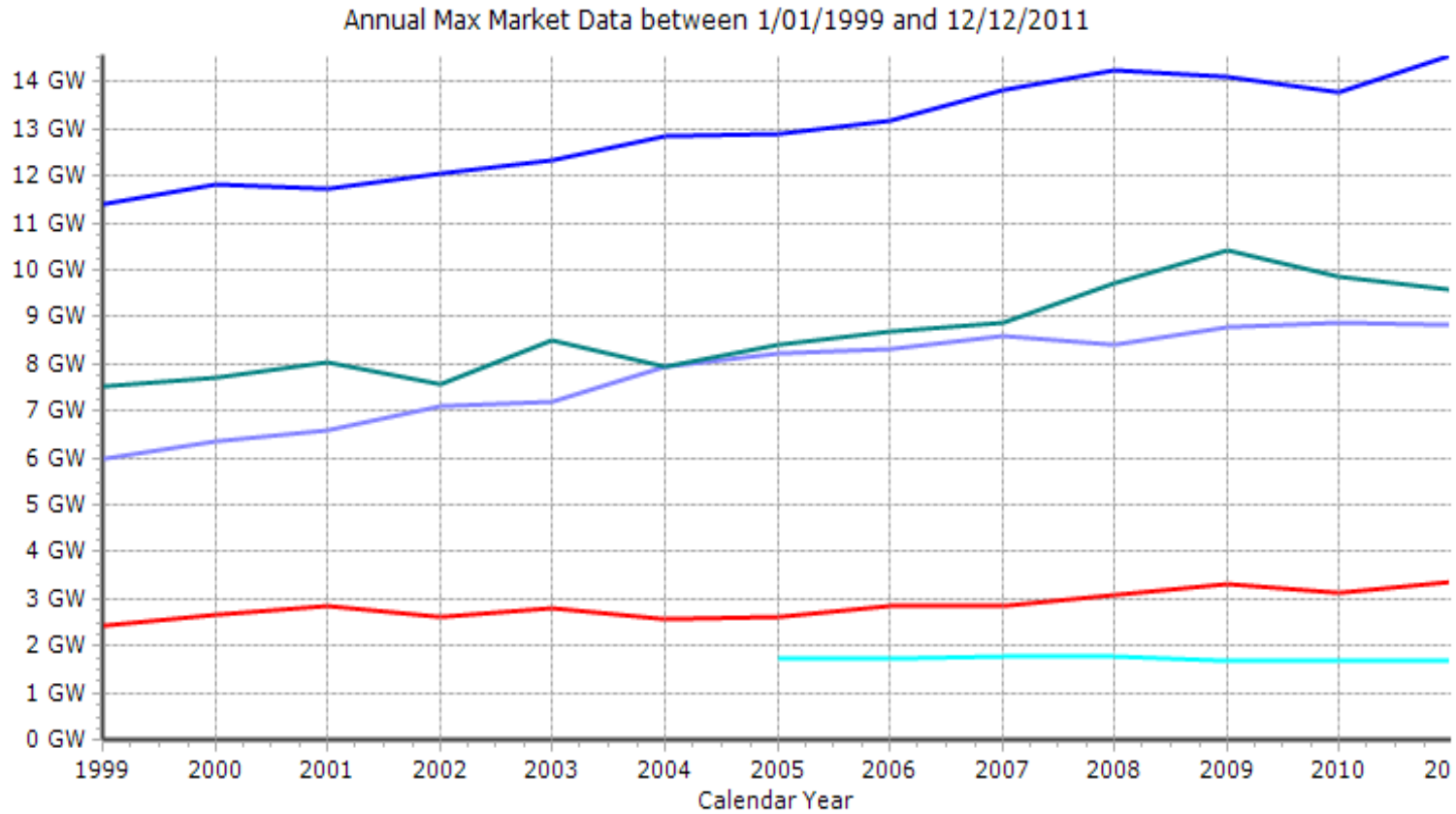
Pricing context - what the chart tells us

- The Western Power claim is excessive
- The Powerlink claim was in the mix to be one of the most expensive transmission companies
- Powerlink is in the same cost grouping as Transend and ElectraNet and significantly more expensive than Powernet and TransGrid. Intuitively this is incorrect as Powerlink has a demand well in excess of these two and a demand comparable to Powernet
- The AER DD puts Powerlink costs back into the expected realm of the mid range between Transend/ElectraNet and Powernet/TransGrid

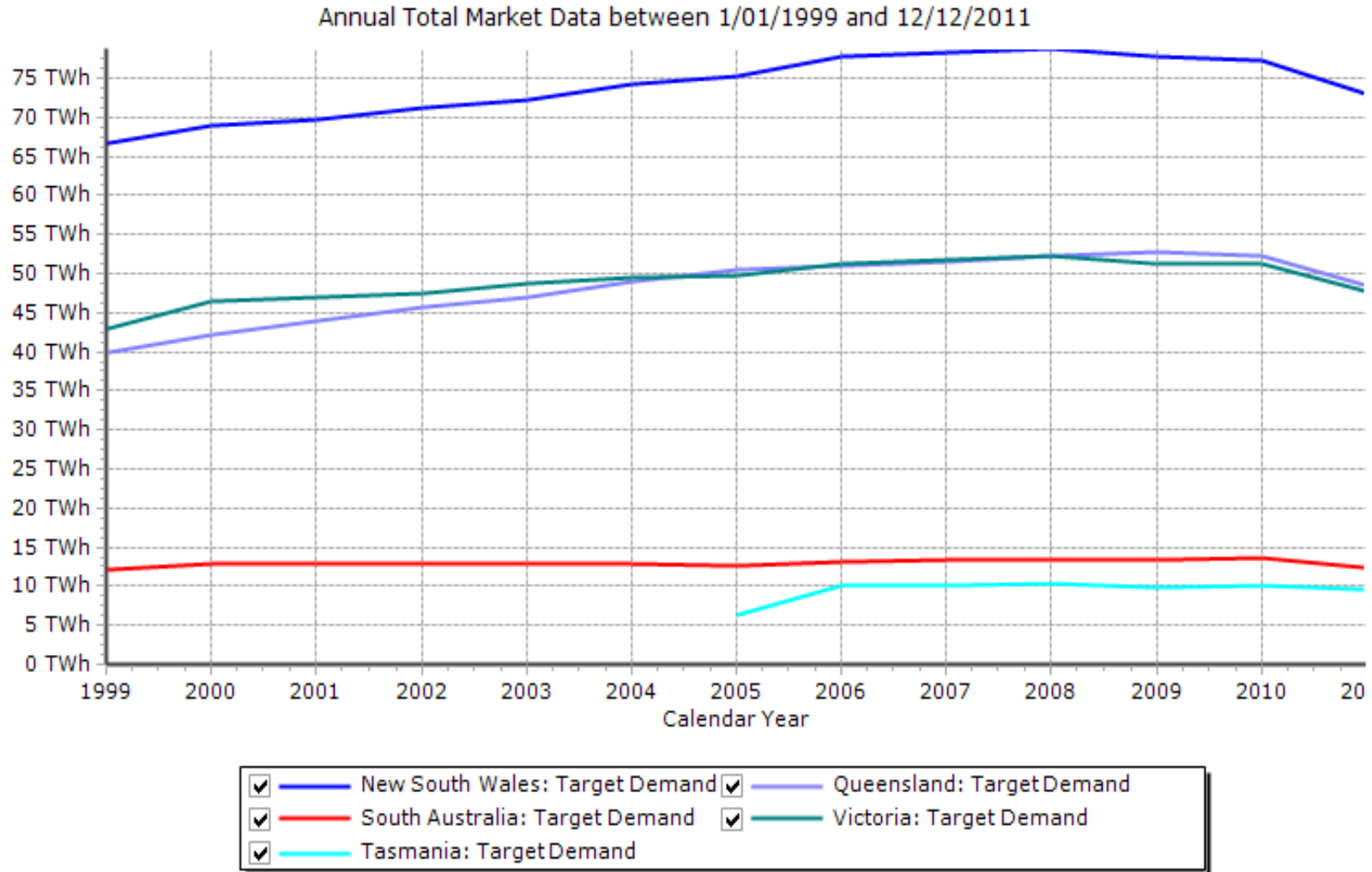
Powerlink revenue trend over time c/f demand



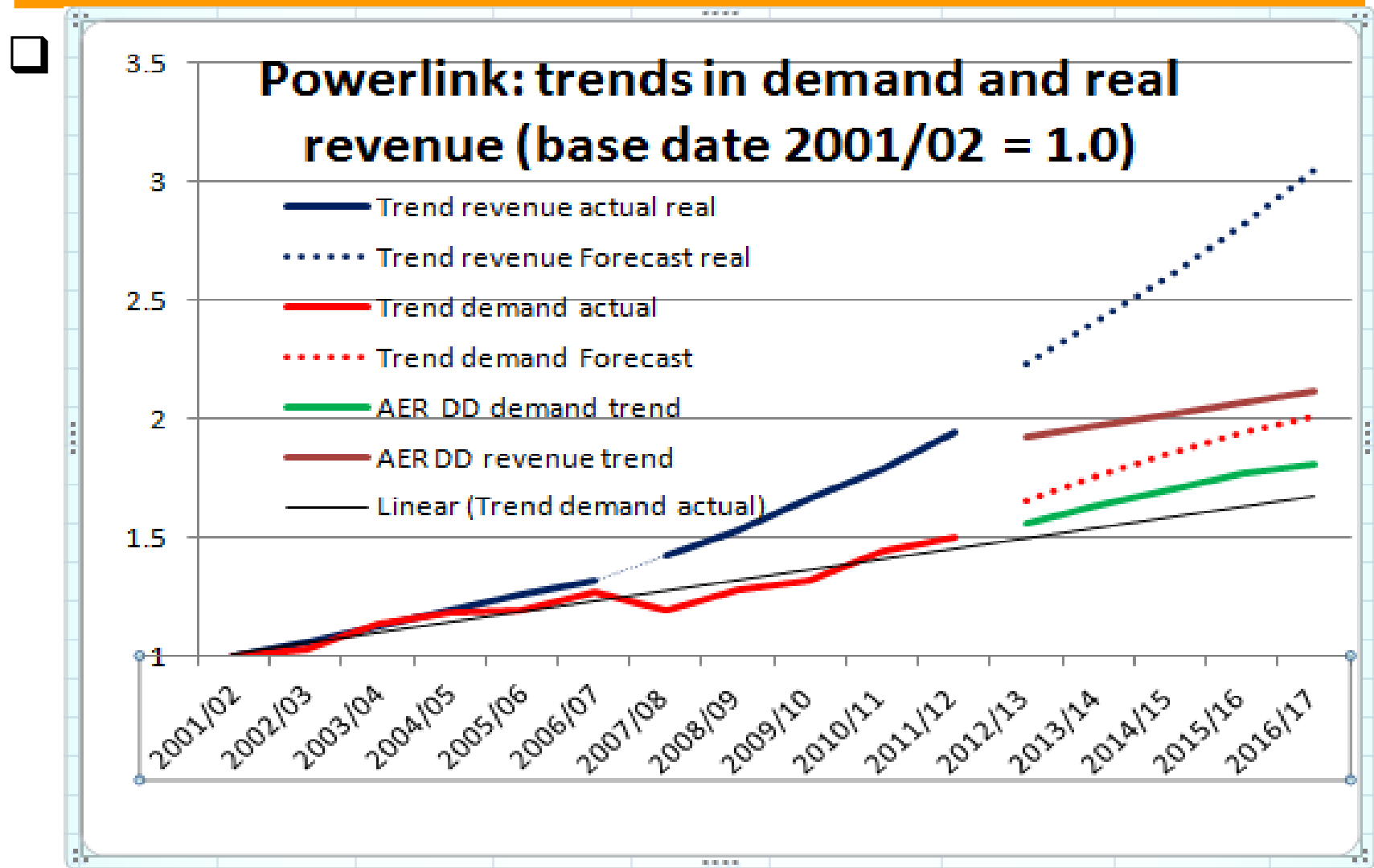
Changing pattern of demand and consumption (1)



Changing pattern of demand and consumption (2)



Powerlink revenue trend over time c/f demand



Revenue trend - what the chart tells us

- ❑ Prior to the last revenue rest review (in AA1), the Powerlink rate of increase of revenue matched the rate of increase of demand
 - ❑ In the last revenue review – AA2 – (carried out under the influence of the changed Chapter 6A rules) shows a disconnect between AA1 and AA2
 - ❑ Powerlink application for AA3 has revenue increasing at a rate dramatically exceeding the Powerlink forecast rate of change in demand
 - ❑ The AER DD for AA3 reduces the rate of increase in demand on quite valid grounds but still exceeds the long term trend.
 - ❑ The AER DD does not reflect the reducing demand and consumption occurring now as a result of generous network tariff increases, or what will happen as wholesale prices increase substantially from the carbon tax, increasing impact of renewables, increasing risks and prudentials.
 - ❑ The AER DD for AA3 change in revenue is also much less than the rate of change of the Powerlink forecast revenue
 - ❑ The AER DD for AA3 rate of change of revenue much better reflects the rate of change of demand than the Powerlink forecasts
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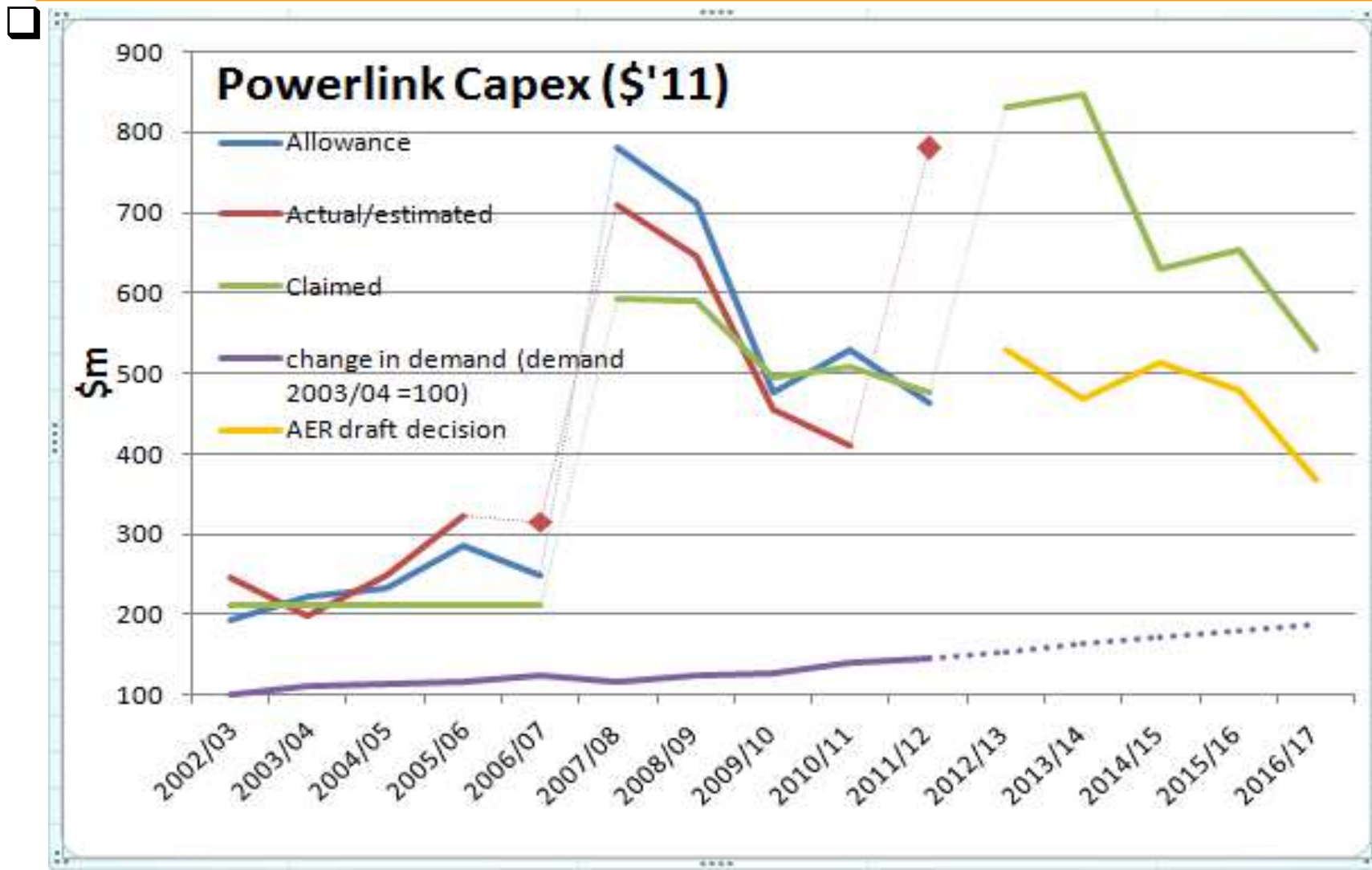
The WACC

- The main impact on the Powerlink application was a reduction in the risk free rate from 5.62% to 4.32%. Essentially this was the CGS market in action
 - Most of the WACC parameters are fixed except for debt risk premium
 - Powerlink operates at 66% gearing yet the AER allows 60%, effectively providing a further benefit as the allowed return on equity is higher than the return on debt
 - The AER has reduced the market risk premium to 600 bp in its recent decisions, yet Powerlink is getting 650 bp
 - Whilst the Group accepts that the WACC parameters are fixed, the AER needs to recognise that its decision is being seen in light of an already inflated WACC
 - The AER has allowed for \$18.9m for the costs of debt raising, yet Powerlink gets its debt from an already secured debt facility, meaning there are no debt raising costs
 - At least the AER did effectively recognise that equity raising costs proposed by Powerlink were inappropriate
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Debt risk premium

- The main issue the Group has is with debt risk premium
 - The AER has proposed a change to the rules about DRP and the networks agree that DRP needs to be addressed
 - But the approach to the DRP by Powerlink and AER is contrary to the NEL although the AER states their draft decision reflects the Rules
 - The debt rate proposed by the AER is 751 basis points yet Powerlink currently pays only ~600 bp
 - It is probable that Queensland bonds will fall in price reducing the cost of debt as Qld bonds trade at only 50 bp above CGS
 - The WACC is required to be efficient and reflect the risks faced by the entity – second reading speech on NEL network principle 4
 - It is inefficient to give a DRP in excess of the likely costs in paying for debt
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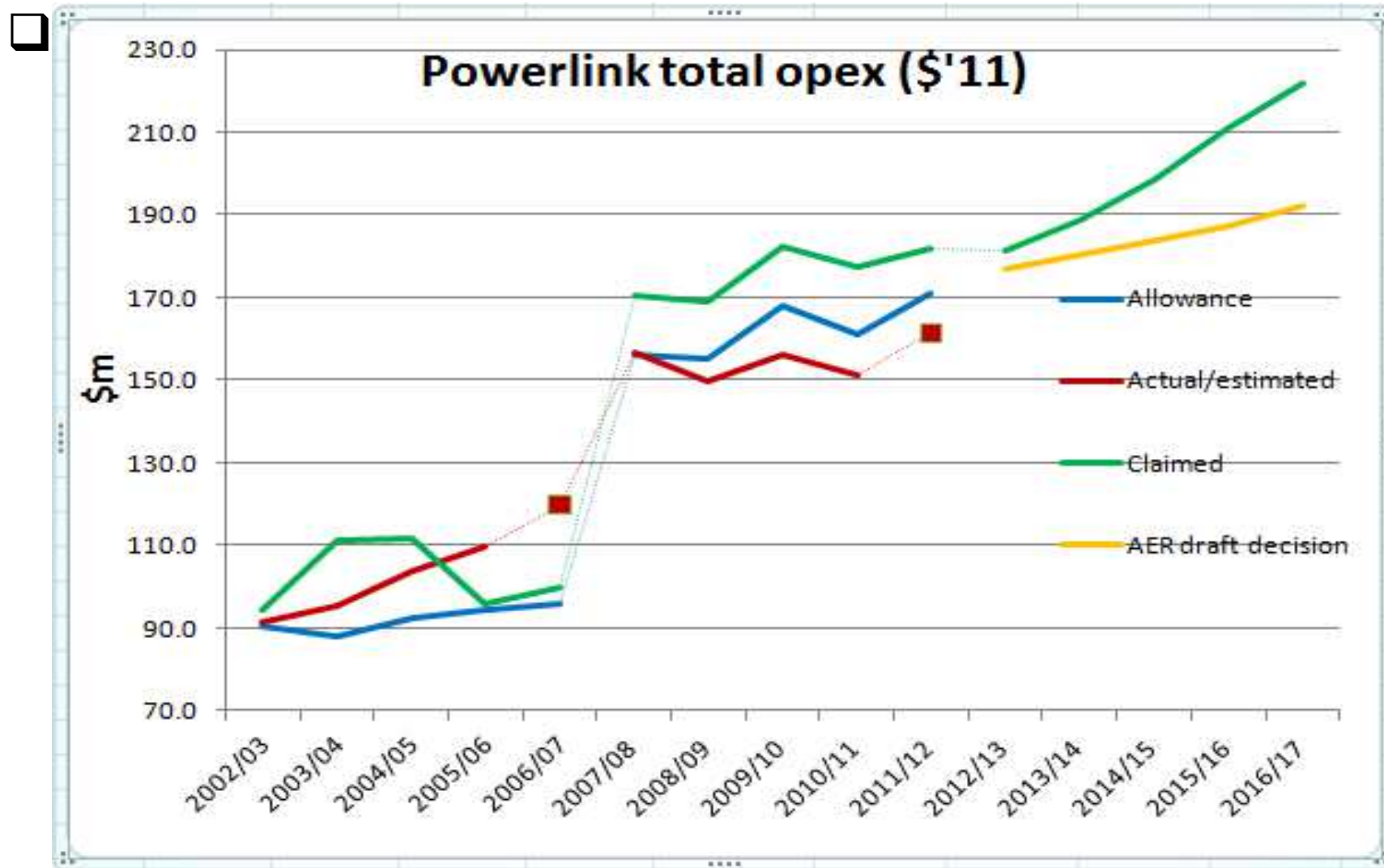
Powerlink Capex over time



Capex trend - what the chart tells us

- In AA1, Powerlink claimed less than it ultimately was allowed which was less than it actually spent
 - In AA2, Powerlink initially sought much less capex than it finally sought and was granted, yet underspent its allowance – the estimated allowance for 11/12 is 40% greater than the average annual capex of the first 4 years raising concerns about its accuracy and use in forecasts for AA3
 - For AA3, increased by >25% its capex claim from the average actuals of the first four years of AA2
 - The AER draft decision delivers an average annual capex 15% less than the annual actual average capex for AA2. This reflects a lower rate of increase in demand
 - Overall, the AER DD reflects previous trends, a rebalancing of capex to historical levels, and the rate of increase in peak demand
 - The Group supports the AER decision that as Powerlink would still operate the elements at 275 kV the upgrade to permit future operation at 500 kV should not occur at this time
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Powerlink opex over time



Opex trend – what the chart tells us

- In AA1, opex was insufficient and Powerlink overspent its allowance
 - In AA2, Powerlink overstated its needs, was granted a smaller allowance and underspent its allowance by some \$50m
 - An EBSS was in place for AA2 to provide an incentive to reduce opex, but Powerlink claims its controllable opex did not under-run and the savings were from outside its control. So Powerlink benefits and consumers pay.
 - There is little doubt that Powerlink opex claim is grossly overstated
 - Actual opex should be the start point for future opex. Despite this the AER has allowed a starting opex 15% above the average actual opex
 - The AER allows an annual increase of 2% real yet during AA2 the opex was essentially constant in real terms
 - The Group provided segmented analysis of the Powerlink claim yet the AER has effectively disregarded this work
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Service Performance – AER DD

| Parameters | Historic performance | AER Proposed values | | | | Better for Powerlink |
|---|----------------------|---------------------|--------|-------|-----------------|----------------------|
| | | Collar | Target | Cap | Weighting % MAR | |
| Transmission circuit availability (%) | | | | | | |
| Transmission line availability | 98.9 | 97.60 | 98.76 | 99.92 | 0.10 | yes |
| Transformers availability | 98.8 | 98.27 | 98.76 | 99.24 | 0.10 | yes |
| Reactive plant availability | 97.5 | 94.45 | 97.15 | 99.84 | 0.15 | yes |
| Peak transmission circuit availability | 98.78 | 98.31 | 98.76 | 99.20 | 0.10 | yes |
| Loss of supply event frequency (no.) | | | | | | |
| >0.75 (y) system minutes | 0.5 | 2 | 1 | 0 | 0.15 | yes |
| >0.10 (x) system minutes | 3.75 | 6 | 4 | 2 | 0.30 | yes |
| Average outage duration (minutes) | | | | | | |
| Average outage duration | 800 | 1306 | 859 | 412 | 0.10 | yes |
| Market Impact of Transmission Congestion | 1423 | 1442 | | | | yes |

Service Performance trend – what the table tells us

- The AER has made the service target more difficult than Powerlink proposed**
- But if Powerlink maintains the past average performance it will be given a STPIS bonus**
- What the AER overlooks is that the STPIS is intended to incentivise an improvement in service performance as this is what is expected of the competitive sector.**
- The competitive sector must continually improve its service performance “just to stand still”**
- The Group considers that the earning of a bonus must require effort and not be the result of maintaining historic performance.**

Summary

- The Powerlink application would have resulted in considerable harm to consumers and at the same time, provide a lesser performance or deliver an unearned bonus
 - Overall, the AER draft decision is better for consumers, even though the AER has still provided Powerlink with more revenue than Powerlink past performance would indicate
 - Consumers are very concerned the AER has unnecessarily given consumer money to Powerlink due to the DRP decision
 - The Group is concerned that too little note has been taken of the price elasticity effect of higher prices (such as the AER generosity in this draft decision) will have on future demand
 - From a consumer viewpoint, the service performance is likely to reduce because the targets do not provide a challenge
 - What consumers fear is that Powerlink will seek to improve its financial position and so erode those consumer benefits embedded in the draft decision.
 - We note that the Queensland government is already concerned with too high retail prices and this draft decision will not help
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