Minutes of the Pre-determination Conference for TransGrid and NSW transmission and distribution draft determinations

(1 July 2009 to 30 June 2014)

Location: Swissotel Sydney

68 Market Street, Sydney

Date: Tuesday, 9 December 2008 (9:00 am to 2:30 pm)

Forum Chair: Steve Edwell, Australian Energy Regulator

Attendees: the meeting commenced with 71 registered attendees and 11 AER staff

Organisation	Attendees
TransGrid	David Conroy, David Tretheway, John Howland, Peter McIntyre, Tony Meehan, Kevin Murray
Country Energy	Natalie Lindsay, Jason Cooke, Bill Frewen, Catherine Waddell.
EnergyAustralia	Trevor Armstrong, Geoff Lilliss, Catherine O'Neill, Terry Fagan, Jane Smith, Matt McQuarrie.
Integral Energy	Rod Howard, Karen Waldman, Mike Martinson, Matt Webb, Jon Hocking, Frank Neville.
Consultants	Peter Williams (PB), Victor Petrovski (PB), Lionel Chin (MMA), Jeffrey Wilson (Wilson Cook).
Other organisations and user groups	James Flavin (Bixby Pty Ltd) Craig Bajraktarevic-Hayward (Parramatta City Council) Tony Pfeiffer, Troy McKay-Lowndes (Ergon Energy) Michael Machin (Norske Skog Paper Mills) Andris Karklins (Blacktown City Council) Peter Donley, Paul Gowans (City of Sydney Council) Neil Andersen, Kevin Kehl (Energex) Chris Dunstan (UTS) Andrew Cooper (City of Ryde) Graham Mawer (Next Energy) Neil Watt (CitiPower), Matthew Serpell (Powercor Australia) Kate Jdanova (SP AusNet) Malcolm Ackerman (Penrith City Council) David Lewis (SSROC)

	Merryn York (Powerlink) Anthony Saker (UMS Group) Bob Lim, David Headberry (EMRF/MEU) Scott Maves, Roman Domanski (EUAA/End User) Graham Higham, Mark Della (NSW Treasury) Jim Turner (Ku-ring-gui Council) Luke Woodward Gilbert and Tobin) Margaret Beardow (Benchmark Economics).
Australian Energy Regulator (AER)	Steve Edwell (Chair), Andrew Reeves, Mike Buckley, Donella Greer, Kenny Yap, Scott Haig, Lawrence Irlam, Ian McNichol, Danielle Staltari, Toby Holder, Sonja Tasovac.

Summary of forum

A summary of the forum is set out below.

1. Opening remarks by the Chair

Steve Edwell (Chair) opened the forum. The Chair outlined the following:

- The forum was a formal conference, as required under the National Electricity Rules (NER) and officially launched the public consultation process for the AER's draft determinations for TransGrid, EnergyAustralia and Integral Energy, with a record of the meeting to be made available on the AER website.
- Written submissions are required by 16 February 2009 and requested oral submissions made at the forum be provided, in writing, to the AER.
- Key aspects of the transitional arrangements for TransGrid, EnergyAustralia and Integral Energy and common elements of the AER's draft determinations across the businesses for the 2009–14 regulatory control period.

The AER's presentation slides are available on the AER's website at

http://www.aer.gov.au/content/index.phtml/itemId/723187

2. Presentation by David Headberry – Energy Markets Reform Forum

The Chair invited David Headberry (Public Officer) representing the Energy Markets Reform Forum (EMRF) to present to the forum.

The EMRF's presentation slides are available on the AER website at

http://www.aer.gov.au/content/index.phtml/itemId/723187

David Headberry (**EMRF**) provided an overview of the EMRF's general concerns regarding the AER's draft determinations for the 2009–14 regulatory control period. The following main points were covered:

- A conservative view by the AER on each element of the building blocks results in increased costs which compound to a much higher return than should be allowed. The EMRF believes regulatory conservatism should only be added at the end of the process.
- Concern that NSPs will collectively spend $18 billion over the next five years and whether this is deliverable given the economic downturn.
- Given current economic conditions, increases in labour and materials forecasts are considered optimistic and out of date. Particularly, there has been a 15 per cent reduction in material costs, while downward pressures on labour prices should result in lower wage costs.
- Deviations from self set benchmarking by the businesses for opex and capex requires justification.
- Growth forecast should be revisited due to changing business and consumer behaviours.
- Concerns tariff increases are too high and whether customers are able to afford price increases as a result of the AER's draft decisions.

The Chair responded to David Headberry's comments and advised that the AER undertook a very comprehensive analysis in preparing its draft determinations. Whilst criticisms of the draft determinations were welcomed as part of the process, such criticisms needed to be supported. The Chair invited stakeholders to review the AER's methodologies and analysis and to forward submissions on issues where the AER got it wrong with supportive arguments.

The Chair advised that the current review of the WACC is being undertaken as a separate review process as required under the NER and will not affect the NSW determinations. The Chair noted that updated data for cost escalators will be used in the AER's final decisions.

3. Responses to issues raised on TransGrid, EnergyAustralia and Integral Energy presentation

Roman Domanski (EUAA) agreed with David Headberry's presentation and provided comments similar to the EMRF. Mr Domanski's preliminary comments (which will be forwarded in more detail with a submission to the AER) noted energy users are facing additional pressure due to cost increases on multiple fronts, including rising wholesale electricity prices and gas prices, a carbon price, a higher RET and significant increases in NSW network charges if the draft decision is implemented. The EUAA and its members believe the business' regulatory proposals in addition to the AER's draft decisions are not helpful in that regard.

Mr Domanski believes the AER has not taken account of the economic downturn in its draft determinations and requested it be done for the final determinations.

The EUAA is further concerned with implications associated with increased prices, regulatory gaming in terms of increased capex, and is not convinced that labour and material costs will continue to increase above CPI. While the EUAA acknowledges the work of the AER taking account of labour cost forecasts from Econtech and the reduction of some opex costs, the EUAA is concerned that there does not appear to be any productivity gains that the businesses are expected to make and that very limited inroads into capex are apparent.

Margaret Beardow (Benchmark Economics) acknowledged the need for increased costs to replace old assets and maintain reliability. Ms Beardow stated if sufficient capex is not spent by 2014, the amount of assets over 40 years, currently 30 per cent, will increase to 40 per cent. Subsequently, this will likely lead to increasing failure rates or increased maintenance costs. Ms Beardow noted that assets have been allowed to deteriorate in the past as consumers lobbied for lower electricity prices.

Chris Dunstan (Institute for Sustainable Features) asked if the AER's analysis has taken account of the announced and likely policies in the next regulatory control period pertaining to reductions in emissions trading scheme and if so, what impact this has on the analysis?

Steve Edwell responded that it was difficult to take into account the emissions trading policy when compiling the draft decisions as the policy was not in place and there is still uncertainty as to when a scheme will start. Further, any impact on demand will likely affect the later years of the regulatory control period. With respect to the carbon pollution reduction scheme, Mr Edwell noted none of the states have committed to passing costs onto consumers.

Chris Dunstan (Institute for Sustainable Features) asked if the DNSPs invest in demand management initiatives over the next five years which will reduce peak demand and energy consumption for customers, will the AER's draft decision ensure the DNSPs are not left out of pocket. Further, Mr Dustan asked if there are incentives for businesses to invest in such initiatives.

Steve Edwell responded that the D-Factor will pick up on part of the compensation if they lose out in a revenue sense.

Mr Edwell advised that the AER approves a pool of money for demand management initiatives, how such monies and allocations are spent is up to the individual business. With respect to capex and opex, the intent of the policy is to not leave businesses with a shortfall. Mr Edwell acknowledged that, in part, the D-Factor will compensate the businesses if they lose out on revenues.

Bob Lim (EMRF) asked how the announcement of the NSW mini budget of $815 billion deferred capex was reconciled with the applications received.

Steve Edwell noted that announcement of the NSW mini budget was too late for the AER to take into account in its draft determinations. Mr Edwell stated that based on his understanding, the effect of NSW mini budget may be to move expenditure from capex to opex, rather than changing the expenditures proposed by the businesses. For example, leasing motor vehicles rather than purchasing them. Mr Edwell commented that the effect of the NSW mini budget will be taken account of in the final determinations.

Bob Lim (EMRF) questioned the credit markets ability to finance capital expenditure.

Steve Edwell advised this issue was considered in the AER's WACC review. Mr Edwell noted that a proposed statement on the WACC parameters would be released by the AER on 11 December 2008. Where the AER considers that expenditure proposed by the businesses is reasonable and efficient, it is difficult to form a basis of reducing the expenditure on the basis that there may be difficulty with raising finance. Subsequently, the AER falls back on incentives in the current regulatory framework.

James Flavin (Bixby Pty Ltd) raised concerns about step changes in the cost of energy and increased costs of electricity bills. Mr Flavin advised such increases will stretch resources for agencies such as Anglicare, who provide assistance to those unable to pay their bills.

Steve Edwell advised that it is difficult for the AER to consider social welfare issues where the businesses have put forward reasonable cases for expenditures required during the next regulatory control period. Mr Edwell noted that the AER must adhere to the objects and criteria set out in the National Electricity Rules.

Break 10.40am. Reconvene at 11.10am.

4. Presentation by Steve Edwell: Draft decision – TransGrid transmission determination 2009–10 to 2013–14

- The AERs presentation slides are available at the AER's website at

http://www.aer.gov.au/content/index.phtml/itemId/723187

- Following Mr Edwell's presentation, he opened the floor to questions on the AER's draft determination for TransGrid.

5. Questions from interested parties

Chris Dunstan (**Institute for Sustainable Features**) asked about the elasticity of demand between growth in energy and maximum demand in TransGrid's demand forecast.

Mike Buckley (AER) advised MMA concluded that growth in energy consumption is slowing but not to the same extent as growth in maximum demand. Subsequently, this is driving disparity in pricing as more networks are needed to deliver smaller amounts of energy for short periods of time. Mr Buckley further advised this subsequently results in the need for increased investment to serve maximum demand even though energy consumption is not growing at the same rate as maximum demand.

Chris Dunstan (**Institute for Sustainable Features**) asked if TransGrid will be required to review its maximum demand forecasts for the final decision.

Mike Buckley (AER) advised under the national electricity arrangements, processes for the businesses deriving their demand forecasts are set by NEMMCO. The role of the AER is to ensure that businesses comply with NEMMCO requirements.

Bob Lim (EMRF) noted land easements represented 10–11 per cent of TransGrid's total capex and considered this to be high. Mr Lim asked if TransGrid's easement expenditure was reasonable.

Peter McIntyre (TransGrid) advised that pay outs for easements are made in compensation for land. Compensation is dependent on the impact on the value of the land. Mr McIntyre noted that TransGrid has a number of projects in urban Sydney which have greater compensation amounts. As such, TransGrid is not paying abnormal compensation amounts for easements.

Lawrence Irlam (AER) noted that overall the AER had no concerns with the easement expenditure proposed by TransGrid. Mr Irlam noted that the AER had reviewed one easement project proposed by TransGrid and made one minor adjustment.

Roman Domanski (EUAA) acknowledged that the AER had made some adjustments to the capex (limited) and opex (somewhat more useful) expenditures proposed by the businesses. Mr Domanski noted that he had concerns with the increases in real opex and capex for the years 2008–09 to 2009–10 and would provide further detail in a submission. Mr Domanski noted end users are ultimately concerned with final prices. Mr Domanski noted that the energy user members had experienced a number of price increases in the current regulatory period. Mr Domanski advised end users were often perplexed by these and the lack of certainty about regulated network charges. Mr Domanski further stated there has been little certainty for users about the timing of these proposed price increases.

Mr Domanski also questioned how confident the AER was that more could not have been done to alleviate the increases in capex. Mr Domanski asked whether demand management initiatives are being used to alleviate increases in capex.

Steve Edwell advised that the role of the AER is to set revenues and approve TransGrid's pricing methodology. The AER does not set prices for TransGrid. Mr Edwell stated the AER will consider what can be done to create more certainty for users in dealing with price increases in transmission charges.

Mr Edwell noted that the AER looked at a number of projects as part of its review of TransGrid's forecast capex. In reviewing the sample of projects, PB and the AER assessed TransGrid's processes in deciding upon options and whether the options had been given suitable consideration. In some instances the AER had made adjustments to reflect more efficient costings. In terms of trying to get more out of demand management initiatives, further broader policy work needs to be done.

Peter McIntyre (TransGrid) noted that customers have not been exposed to the full transmission prices in the NEM. Mr McIntyre acknowledged that there had been some volatility associated with TransGrid's transmission pricing. This volatility was created because of a change in settlement residues in the NEM which affect transmission charges for customers. Mr McIntyre also noted that there were two pass through events in the current regulatory control period which also had an effect on transmission pricing.

6. Presentation by Steve Edwell: Draft decision – EnergyAustralia determination 2009–10 to 2013–14

- The AERs presentation slides are available at the AER's website at

http://www.aer.gov.au/content/index.phtml/itemId/723187

- Mr Edwell opened the floor to questions on the AER's draft determination for EnergyAustralia.

7. Questions from interested parties

David Lewis (Southern Sydney Region of Councils) stated his appreciation to the AER for the way it has conducted its consultation process on the regulatory proposals made by the businesses. Mr Lewis raised the issue of openness and transparency of pricing models for public lighting. He requested that the AER consider a reporting regime similar to that applied in Victoria for public lighting. Mr Lewis noted that the provision of public lighting is a monopoly service and the pricing of this service should be open and transparent.

Steve Edwell advised the suggestion of a reporting regime for public lighting will be taken on board by the AER and noted that this is not inconsistent with the current thinking of the AER. Mr Edwell further acknowledged transparency was a big issue for public lighting going forward.

Chris Dunstan (Institute for Sustainable Features) asked how the expanded roll out of smart metering is incorporated within the AER's draft determinations.

Steve Edwell advised that smart metering is still a policy issue which is under consideration by jurisdictions collectively. Mr Edwell noted that the Victorian government has mandated the roll out of smart metering. The Victorian government has allowed that the costs incurred by DNSPs for smart metering are passed onto customers, provided the costs are assessed by the regulator as being prudent and particular steps have been followed by the DNSPs. The AER will have a role in the smart meter rollout in Victoria when it takes over from the Essential Services Commission of Victoria from 1 January 2009. For the rest of Australia, the Ministerial Council for Energy is working on a national smart meter rollout.

Chris Dunstan (Institute for Sustainable Features) asked does the draft decision facilitate EnergyAustralia spending money on demand management initiatives to reduce peak energy demand?

Trevor Armstrong (**EnergyAustralia**) advised current arrangements include the D-factor regime for demand management initiatives. EnergyAustralia is satisfied that this scheme will assist with capital deferment.

Roman Domanski (EUAA) noted that this was the fourth regulatory control period were a Service Target Performance Incentive Scheme (STPIS) for NSW was yet to be put in place. Mr Domanski stated that a STPIS should apply in the next regulatory control period to the NSW businesses.

Steve Edwell agreed that desirably a STPIS should be in place for the next regulatory control period. He noted however that due to no scheme being in place previously, the AER had to maintain the status quo for 2009/2014 because sufficient information was not available to implement one. This had been previously signalled by the AER together with its view to apply a scheme for the 2014/19 period. Mr Edwell noted that, for the forthcoming period, the NSW DNSPs will have reporting requirements (in order to develop the necessary data) despite no revenue being at risk. Mr Edwell also noted that the NSW government has established performance standards which the businesses must also adhere to.

Break 12.30pm. Reconvene at 1.30pm.

8. Presentation by Steve Edwell: Draft decision – Integral Energy determination 2009–10 to 2013–14

- The AERs presentation slides are available at the AER's website at

http://www.aer.gov.au/content/index.phtml/itemId/723187

- Following Mr Edwell's presentation, he opened the floor to questions on the AER's draft determination for Integral Energy.

9. Questions from interested parties

Bob Lim (EMRF) noted that Integral Energy had applied a 2 per cent productivity factor to its forecast opex. Mr Lim asked why the other businesses had not incorporated a similar productivity factor. Mr Lim suggested benchmarking be undertaken to compare DNSPs in terms of productivity.

Steve Edwell advised that Integral Energy made particular mention of its productivity factor in its regulatory proposal and was part of the AER's consideration in determining whether Integral Energy's opex was reasonable. Irrespective of whether a business proposes a productivity factor, the AER undertakes the same process to determine whether the expenditures proposed by the business are prudent and efficient.

Natalie Lindsay (Country Energy) advised Country Energy included productivity gains in its forecast capex and opex in its regulatory proposal.

Peter McIntyre (TransGrid) stated that TransGrid had a comprehensive opex model which takes into account productivity gains in forecasting TransGrid's opex. For example, TransGrid's opex model removes maintenance costs for assets which are being replaced and applies economy of scale factors to take into account that while TransGrid's asset base is growing, TransGrid can do tasks more efficiently.

Jeffery Wilson (**Wilson and Cook**) advised productivity gains were considered for all NSW DNSPs. Mr Wilson noted that all businesses had included some form of savings in forecasting their expenditures. Mr Wilson noted that extensive benchmarking analysis is outlined in Volume One of the Wilson Cook report.

10. Presentation from David Headberry – comments on DNSP process and outcomes

The EMRF's presentation slides are available on the AER website at

http://www.aer.gov.au/content/index.phtml/itemId/723187

David Headberry provided a presentation pertaining to the DNSP's opex and capex and concluding comments on the EMRF's views of the AER's draft determinations for the 2009–14 regulatory control period. Main points covered:

- Excessive tariffs and impacts on customers
- Changing economic climate since the release of the draft determinations
- Out of date forecasts
- Demand management
- Clawback arrangements for excessive capex to minimise impact on consumers
- Increased benchmarking

Steve Edwell in response to issues raised by the EMRF stated he stands by the assumptions and methodology used by the AER to assess the expenditures proposed by the businesses. However, Mr Edwell noted that the AER would welcome any comments on the methodology, approach and analysis used by the AER in its draft determinations.

Mr Edwell advised the ability of consumers to pay is not something the AER can take into account as part of its role, as it is not part of the criteria in the National Electricity Rules.

Mr Edwell noted the businesses are likely to raise the capital, as they have stable cash flows with locked-in rates of return.

Concluding comments

The Chair reminded participants that submissions close on 16 February 2008.

The Chair further outlined the separate consultation process that would be taking place in relation to public lighting. On March 9 the AER will publish its proposed 2009–2010 tariffs and the AER's proposed price path, for each NSW DNSP and seek submissions on these proposals, due by 23 March 2009.

The Chair expressed his appreciation to the presenters and attendees for their participation and closed the meeting at approximately 2.40 pm.
