

Mr Warwick Anderson  
General Manager, Network Regulation  
Australian Energy Regulator  
GPO Box 520  
Melbourne VIC 3001

**SYDNEY**  
201 Elizabeth Street  
PO Box A1000 Sydney South  
NSW 1235 Australia  
T (02) 9284 3000  
F (02) 9284 3456  
[www.transgrid.com.au](http://www.transgrid.com.au)

Dear Mr Anderson

## **SP AusNet Draft Decision and Revised Revenue Proposal**

TransGrid appreciates the opportunity to provide a submission on SP AusNet's draft decision and revised revenue proposal for the 2014-2017 regulatory control period. This submission responds to three specific matters raised in the draft decision: the asset works expenditure forecast, capital expenditure prudence adjustment and selection of labour escalator.

### **Asset Works Expenditure Forecast**

In its draft decision the AER raised concerns about the use of a bottom-up basis to forecast asset works. The AER expressed a preference for a revealed costs forecasting approach, and raised concerns about the interaction between forecasting on a bottom-up basis and the operation of the Efficiency Benefit Sharing Scheme (EBSS).

Asset works comprises project-based work that is estimated as individual cost estimates and tends to be lumpy in a similar way to capital expenditure, rather than behaving as recurrent costs. It can vary from year to year depending on asset condition and specific needs.

TransGrid supports the proposal by Grid Australia<sup>1</sup> that in circumstances where a bottom-up approach is the best forecasting approach, the most appropriate forecasting approach be used and the application of the EBSS modified to suit the forecasting approach. This will ensure that efficient cost recovery is maintained without compromising the integrity of the incentive schemes.

### **Capital Expenditure Prudence Adjustment**

In its draft decision the AER has applied a "prudence adjustment" to SP AusNet's forecast capital expenditure. TransGrid has concerns with the application of this adjustment.

Firstly, when assessing a NSP's capital expenditure forecasts, the AER needs to consider the NSP's estimating process in its entirety to form a view on its appropriateness. Estimating processes may improve or otherwise change over time in line with good electricity industry practice, and in particular may include feedback loops to take account of NSPs' experience in estimates going forward.

<sup>1</sup> Grid Australia, *Submission in Response to Proposed Efficiency Benefits Sharing Scheme*, 20 September 2013, p5.

Secondly, the assumption that NSPs may be able to defer projects in the future appears biased as it does not appear to take into account situations in which projects may need to be advanced.

Thirdly, the AER appears not to recognise the extent to which the behaviours it has identified have already been taken into account in SP AusNet's forecasts. Notably, in its revised revenue proposal SP AusNet states that, "a large proportion of the network capex program for the 3 year period has already commenced or received business case approval." This would indicate that the potential for prudent changes is limited compared to the previous 6 year period, to which the AER is drawing a comparison.

TransGrid considers that the AER's proposed prudency adjustment is unreasonable on these grounds, and would not allow SP AusNet to recover the efficient costs associated with the delivery of its capital expenditure portfolio.

### **Selection of Labour Escalator**

In its draft decision the AER has substituted SP AusNet's proposed labour escalation with labour escalation provided by Deloitte Access Economics (DAE) stating that DAE's forecasts, "reasonably reflect a realistic expectation of the cost inputs required to achieve the capex objectives."

TransGrid does not agree that DAE's forecasts reflect a realistic expectation of cost inputs. In a report for the AER on the most recent Powerlink revenue determination, DAE found that its forecast for the utilities Labour Price Index (LPI) have generally underestimated actual growth.<sup>2</sup> To the extent that DAE has continued to use the same forecasting methods, the use of DAE's labour escalation is likely to result in a downward bias on forecast expenditures.

TransGrid considers that a more accurate forecast could be developed as an average of the DAE and BIS Shrapnel forecasts, and supports the approach in SP AusNet's revised revenue proposal.

Should you have any questions on this submission, please feel free to contact Andrew Kingsmill, Regulatory Expenditure Manager on 0419 617 340.

Yours faithfully,



**Peter McIntyre**  
**Managing Director**

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<sup>2</sup> Deloitte Access Economics, *Response to Issues Raised in the Powerlink Regulatory Proposal*, 2 March 2012, p25.