Draft Decision

Murraylink Transmission Determination 2023 to 2028

(1 July 2023 to 30 June 2028)

Attachment 6
Operating expenditure

September 2022

AUSTRALIAN ENERGY REGULATOR

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1	30 September 2022	13

Note

This attachment forms part of the AER's draft decision on Murraylink's 2023–28 transmission determination. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Pricing methodology

Attachment 12 – Negotiated services

Contents

6 Operating expenditure

Operating expenditure (opex) refers to operating, maintenance and other non-capital expenses. Forecast opex for prescribed transmission services is one of the building blocks we use to determine a service provider's total revenue requirement.

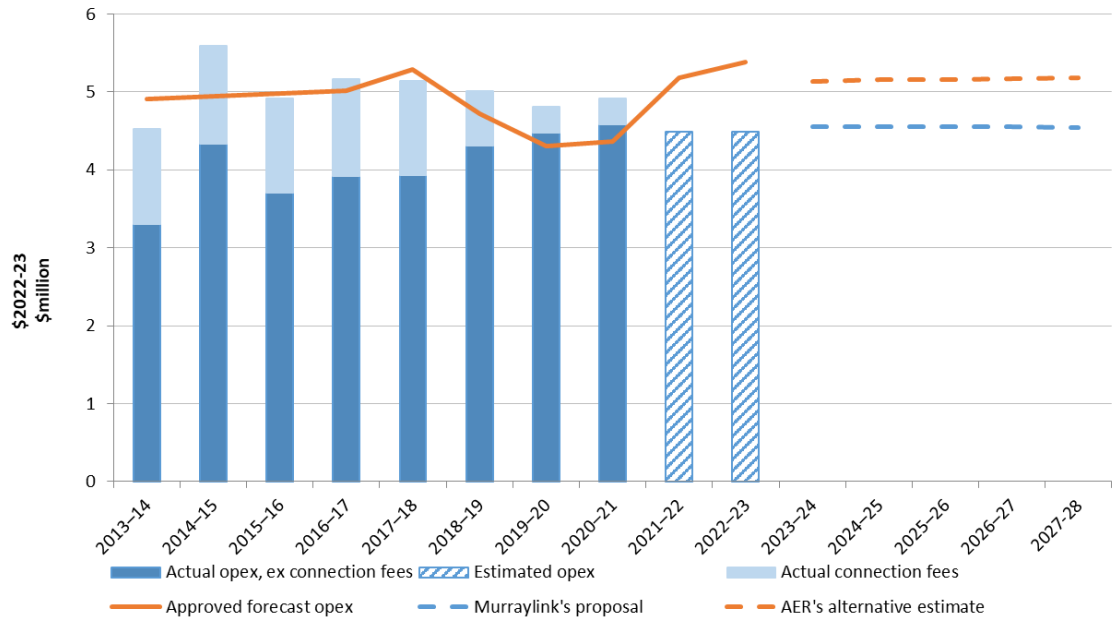
This attachment outlines our assessment of Murraylink's proposed total opex forecast for the 2023–28 regulatory control period.

6.1 Draft decision

Our draft decision is to accept Murraylink's proposed total opex of $22.8 million ($2022–23) for the 2023–28 period.[1] We are satisfied that it reasonably reflects the opex criteria.[2] Opex represents 32.3% of Murraylink's total revenue proposal.

Figure 6.1 shows Murraylink's actual opex and approved forecast in the current period, its opex forecast for the 2023–28 period, and our alternative estimate.

Figure 6.1 Historical and forecast opex ($2022–23 million)



Source: Murraylink, *Economic benchmarking – Regulatory Information Notice response 2006–20*; AER, *Murraylink Final decision PTRM 2008–13*; AER, *Murraylink Final decision 2013–18 PTRM*; AER, *Murraylink Final decision 2018–23 PTRM* and Opex model; Murraylink, *Transmission determination 2023–28 - Overview - 31 January 2022*; AER analysis.

Note: Includes debt raising costs and negative cost pass throughs for 2018–19, 2019–20 and 2020–21 due to reduced connection charges. Further negative cost pass throughs are anticipated for 2021–22 and 2022–23.

1 Murraylink, *Murraylink: Transmission Determination Proposal*, January 2022. p. 10.

2 NER, cl. 6A.6.6(c).

6.2 Murraylink's proposal

In applying a simplified version of our 'base-step-trend' approach to forecast opex for the 2023–28 period, Murraylink:[3]

- used opex in 2020–21 as the base to forecast ($4.3 million)
- did not include the final year increment from the base year
- proposed no opex trend (price, output or productivity) growth
- added forecast debt raising costs ($0.3 million).

Murraylink's total opex proposal is set out in Table 6.1.

Table 6.1 Murraylink's proposed opex ($ million, 2022–23)

$m Real FY23	2023–24	2024–25	2025–26	2026–27	2027–28	Total
Base opex	4.49	4.49	4.49	4.49	4.49	**22.47**
Debt raising costs	0.07	0.06	0.06	0.06	0.06	**0.31**
Total	**4.56**	**4.56**	**4.56**	**4.55**	**4.55**	**22.78**

Note: totals may differ due to rounding
Source: Murraylink, *Murraylink: Transmission Determination Proposal, Operating Expenditure Model,* January 2022; Murraylink, *Murraylink: Transmission Determination Proposal, PTRM,* January 2022.

6.2.1 Submissions on Murraylink's proposal

We received one stakeholder submission from the South Australian government, which requested further itemisation of controllable costs to improve transparency.[4] Murraylink's forecast opex is only categorised as controllable and uncontrollable costs, in addition to debt raising costs. There are no other step changes or category specific costs.

Due to the similarity in costs between the current period and forecast for the 2023–28 period and the simplicity of the application, the AER considers further itemisation unnecessary as costs are unlikely to deviate significantly from the base year itemisation of costs already provided in Murraylink's proposal.[5]

6.3 Assessment approach

Our role is to decide whether to accept a business's total opex forecast. We are to form a view about whether a business's forecast of total opex 'reasonably reflects the opex criteria'.[6] In doing so, we must have regard to the opex factors specified in the National Electricity Rules (NER).[7]

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3 Murraylink, *Murraylink: Transmission Determination Proposal, Operating Expenditure Model,* January 2022.

4 Government of South Australia, Department of Energy and Mining, *Submission on the Murraylink Revenue Proposal 2024-28*, May 2022, p. 2.

5 Murraylink, *Murraylink: Transmission Determination Proposal*, *Operating Expenditure Model,* January 2022.

6 NER, cl. 6A.6.6(c).

7 NER, cl. 6A.6.6(e).

The Expenditure forecast assessment guideline (the Guideline), together with an explanatory statement, sets out our assessment approach in detail.[8] While the Guideline provides for greater regulatory predictability, transparency and consistency, it is not mandatory. However, if we make a decision that is not in accordance with the Guideline, we must state the reasons for departing from the Guideline.[9]

Our approach is to assess the business's forecast opex over the regulatory control period at a total level, rather than to assess individual opex projects. To do so, we develop an alternative estimate of total opex using a 'top-down' forecasting method, known as the 'base-step-trend' approach.[10] We compare our alternative estimate with the business's total opex forecast to form a view on the reasonableness of the business's proposal. If we are satisfied the business's forecast reasonably reflects the opex criteria, we accept the forecast.[11] If we are not satisfied, we substitute the business's forecast with our alternative estimate that we are satisfied reasonably reflects the opex criteria.[12]

In making this decision, we take into account the reasons for the difference between our alternative estimate and the business's proposal, and the materiality of the difference. Further, we take into consideration interrelationships between opex and the other building block components of our decision.[13]

Figure 6.2 summarises the base–step–trend forecasting approach.

8 AER, *Expenditure forecast assessment guideline for electricity transmission*, November 2013; AER, *Expenditure forecast assessment guideline, Explanatory statement*, November 2013.

9 NER, cl. 6A.2.3(c).

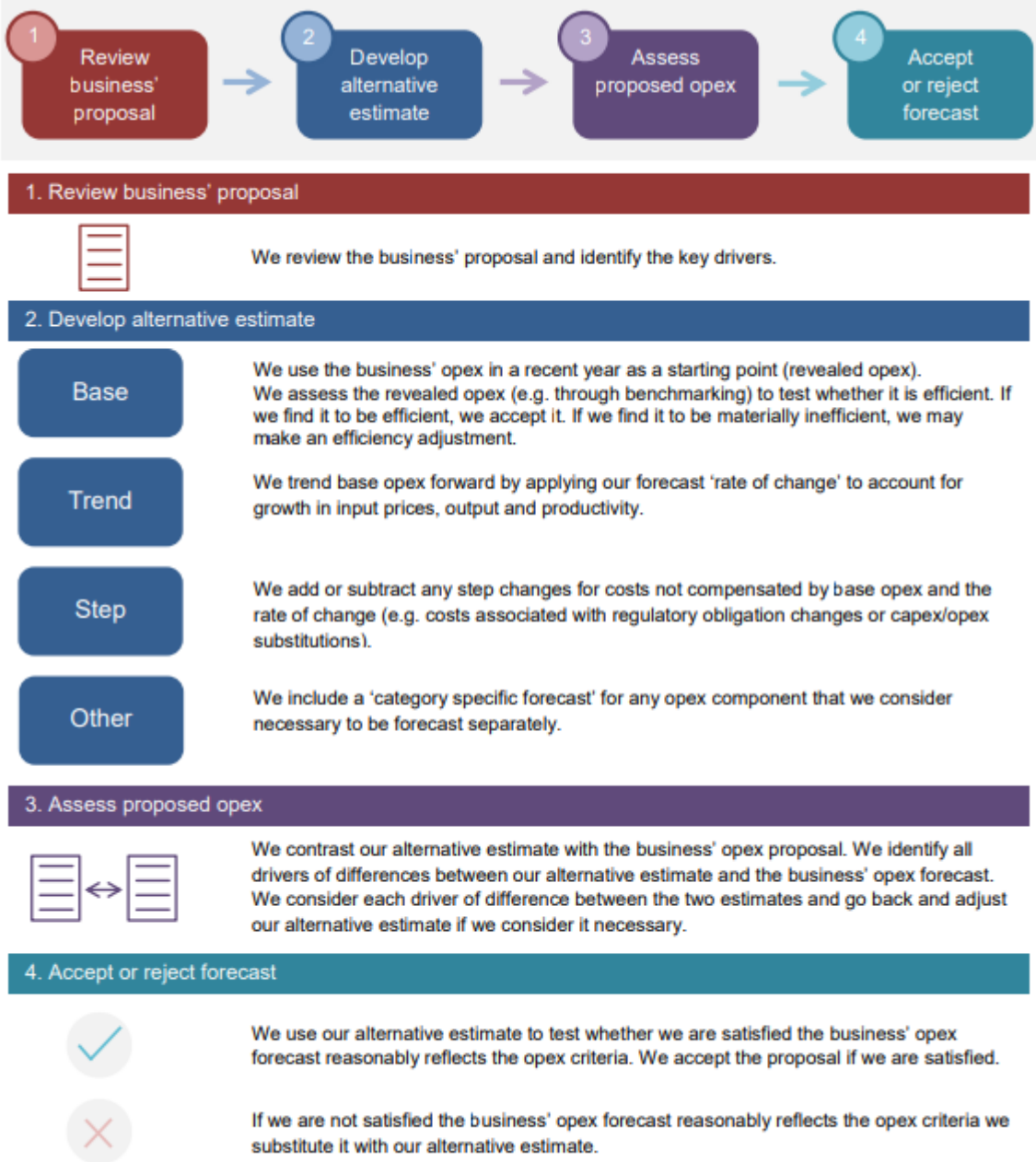
10 A 'top-down' approach forecasts total opex at an aggregate level, rather than forecasting individual projects or categories to build a total opex forecast from the 'bottom up.'

11 NER, cl. 6A.6.6(c).

12 NER, cll. 6A.6.6(d) and 6A.14.1(3)(ii).

13 NEL, s. 16(1)(c).

Figure 6.2 Our opex assessment approach



6.3.1 Interrelationships

In assessing Murraylink's total forecast opex, we took into account other components of its proposal and our determination, including:

- the Efficiency Benefit Sharing Scheme (EBSS) carryover—the level of opex used as the starting point to forecast opex (the final year of the current regulatory control period (2018-23)) should be the same as the level of opex used to forecast the EBSS carryover. This consistency ensures that the business is rewarded (or penalised) for any efficiency gains (or losses) it makes in the final year the same as it would for gains or losses made in other years

- the operation of the EBSS in the 2018–23 regulatory control period, which provided Murraylink an incentive to reduce opex in the base year
- the impact of cost drivers that affect both forecast opex and forecast capital expenditure (capex). For instance, forecast labour price growth affects forecast capex and our forecast price growth used to estimate the rate of change in opex
- the approach to assessing the rate of return, to ensure there is consistency between our determination of debt raising costs and the rate of return building block.

6.4 Reasons for draft decision

Our draft decision is to accept Murraylink's proposal for a total opex forecast of $22.8 million ($2022–23), including debt raising costs, for the 2023–28 period.[14]

Our alternative estimate of total opex ($25.8 million) is $3.0 million higher than Murraylink's forecast opex. This is primarily due to the use of updated actual and forecast inflation figures, however our alternative estimate would still be higher than proposed ($24.1 million, $1.3 million higher) if these inflation figures were not updated. The updated actual and forecast CPI figures used in our alternative estimate are significantly higher than the CPI estimates used by Murraylink in its proposal. In the final decision, we will use updated inflation numbers in our assessment to reflect the most up-to-date CPI forecast at the time of publication. As Murraylink's forecast opex was lower than our own and would be lower even if inflation was not updated, we are satisfied that Murraylink's proposal satisfies the opex criteria.[15]

Table 6.2 sets out Murraylink's proposal and our alternative estimate that is the basis for the draft decisions and key differences.

14 Murraylink, *Murraylink: Transmission Determination Proposal*, January 2022. p. 14.

15 NER, cll. 6A.6.6(c)–(d).

Table 6.2 Our alternative estimate compared to Murraylink's proposal ($million 2022–23)

	Murraylink	Our alternative estimate	Difference
Based on reported opex in 2020–21	22.5	24.6	2.1
2020–21 to 2022–23 increment	–	0.7	0.7
Output growth	–	–	–
Price growth	–	0.5	0.5
Productivity growth	–	–0.4	–0.4
Step changes	–	–	–
Total opex, excluding debt raising costs	**22.5**	**25.4**	**3.0**
Debt raising costs	0.3	0.4	0.1
Total opex, including debt raising costs	**22.8**	**25.8**	**3.0**

Note: totals may differ due to rounding
Source: Murraylink, Murraylink: Transmission Determination Proposal, *Operating Expenditure Model*, January 2022; Murraylink, Murraylink: Transmission Determination Proposal, *Operating Expenditure Model, PTRM*, January 2022.

We discuss the components of our alternative estimate below. Full details of our alternative estimate are set out in our opex model, which is available on our website.

6.4.1 Base opex

This section provides our view on the prudent and efficient level of base opex that we consider Murraylink would need for the safe and reliable provision of services over the 2023–28 regulatory control period.

We have accepted Murraylink's proposed base year of 2020–21 and base year opex of $4.3 million.[16] For our alternative estimate, our base year opex is higher as we have applied the latest actual and forecast inflation inputs. Our updated figure for actual CPI for 2021–22 is 6.1%, and forecast CPI for 2022–23 is 6.2%[17]. This is significantly higher than the CPI estimates used by Murraylink in its proposal.

6.4.1.1 Efficiency of base opex

Murraylink's opex was subject to the incentives of an ex-ante regulatory framework including the application of an efficiency benefit sharing scheme in the 2018–23 period. This gave it an incentive to reduce its opex in its proposed base year.

Murraylink's actual base year opex exceeded its allowance by $0.6 million once a negative cost pass through for a reduction in connection fees is factored in. However, due to the

16 Murraylink, *Murraylink: Transmission Determination Proposal, Operating Expenditure Model*, January 2022.

17 Reserve Bank of Australia, Statement on monetary policy, August 2022.

relatively low value of the proposal, and information provided by Murraylink regarding growth in insurance costs and commercial service fees,[18] we do not consider this overspend sufficient evidence to suggest Murraylink's base year opex was materially inefficient. Therefore, we consider it reasonable to use the opex Murraylink incurred in 2020–21 to forecast base opex (excluding debt raising costs).

6.4.2 Rate of change

Having determined base opex as an efficient starting point, we trend it forward to account for the forecast growth in prices, output and productivity. We refer to this as the rate of change.[19]

Murraylink did not include a forecast rate of change, including for price, output growth and productivity growth. Murraylink stated that it has noticed a long term increase in operational costs, but difficulty identifying drivers, aside from the insurance and commercial service charges, and the age of some of the assets, inhibits forecasting increased costs in the 2023–28 period.[20]

Our alternative estimate includes price growth and productivity growth forecasts. Consistent with Murraylink, we did not include any output growth. This alternative forecast rate of change increases opex, on average, by 0.1% each year, contributing $0.1 million ($2022–23), or 0.6%, to our alternative opex of $25.8 million ($2022–23).

6.4.2.1 Forecast price growth

We have used a forecast average annual real price growth of 0.6%, which increases our alternative estimate by $0.5 million ($2022–23). Murraylink's proposal did not include any price growth.

Our real price growth forecast is a weighted average of forecast labour price growth and non-labour price growth:

- to forecast labour price growth, we have used the forecast of growth in the wage price index (WPI) for the South Australia electricity, gas, water and waste services (utilities) industry. As Murraylink did not provide WPI forecasts, we have used an average of forecasts from our consultant KPMG[21] and the BIS Oxford Economics forecasts for South Australia submitted in ElectraNet's 2023–28 proposal, to which we have added the superannuation guarantee increases as relevant
- we applied a forecast non-labour real price growth rate of zero
- we applied benchmark input price weights of 70.4% and 29.6% for labour and non-labour, respectively.

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18 Murraylink, *Murraylink: Transmission Determination Proposal*, January 2022, p. 14; Murraylink: Response to Information Request 006B - Opex, July 2022;

19 AER, Expenditure forecast assessment guideline - transmission, November 2013, pp. 23–24.

20 Murraylink, *Murraylink: Response to Information Request 006B - Opex*, July 2022; 7 July 2022 Meeting with AER and Murraylink.

21 KPMG, WPI Report, August 2022, p. 10.

6.4.2.2 Productivity growth

We have included a forecast productivity growth of 0.5% per year in our alternative estimate, consistent with our 2021 Annual Benchmarking Report and the productivity growth we forecast for other transmission network service providers.

We note that Murraylink previously did not have a productivity growth forecast and did not forecast productivity growth for the 2023–28 period. However, we consider it prudent to include a productivity forecast in our alternative estimate, as we consider a productivity growth factor captures the improvements in good industry practice that should be implemented by efficient operators as part of business-as-usual operations (e.g. through new technology or management practice changes). We provide further information on our decision to forecast productivity growth for network operators in our March 2019 final decision on forecasting productivity growth for electricity distribution network service providers.[22]

6.4.2.3 Forecast output growth

Consistent with Murraylink's proposal for both opex and capex, we have not included any forecast output growth.

6.4.3 Step changes

Murraylink's proposal did not include any step changes.

6.4.4 Category specific forecasts

We accept Murraylink's forecasting approach for debt raising costs, which is consistent with ours.

Debt raising costs are transaction costs incurred each time a business raises or refinances debt. Our preferred approach is to forecast debt raising costs using a benchmarking approach rather than a service provider's actual costs in a single year. This provides for consistency with the forecast of the cost of debt in the rate of return building block.

We have not included any other category specific forecasts, consistent with Murraylink's proposal.

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22 AER, *Final decision paper – Forecasting productivity growth for electricity distributors,* March 2019.

Glossary

Term	Definition
AER	Australian Energy Regulator
Capex	Capital expenditure
EBSS	Efficiency Benefit Sharing Scheme
NER	National Electricity Rules
Opex	Operating expenditure
WPI	Wage price index