

Expenditure Forecast Assessment Guidelines

Working Group meeting No. 18

Summary of meeting – 13 June 2013

Expenditure setting process and scope of the guidelines

Held via video link between AER's Melbourne and Sydney offices.

On 13 June 2013, the AER, as part of its Better Regulation package, hosted a working group meeting on the development of the expenditure forecast assessment guidelines (the Guidelines). The meeting was chaired by AER Directors Lawrence Irlam and Mark McLeish. A full attendee list can be found in Attachment A.

This summary outlines the key topics and themes of the meeting, including views expressed at the meeting, without ascribing particular comments to any one individual or organisation. The outline broadly follows that of the agenda.

1 *Summary of main discussion*

The objectives of the workshop were to:

- discuss the potential scope of the draft guidelines and explanatory statement
- discuss the expenditure setting process, and
- discuss transitional issues associated with the new expenditure assessment approach.

The presentation given by AER staff on each of these matters is available on the AER's website alongside this summary.¹

2 *General matters raised*

User representatives considered that the AER should be open to applying particular assessment techniques to expenditure forecasts submitted by gas service providers as well as for electricity networks.

NSP representatives questioned whether the AER would review NSPs' governance arrangements in forming a view of the efficiency of their expenditure proposals. Participants discussed the relevance of governance arrangements to the accuracy and robustness of expenditure forecasts.

¹ <http://www.aer.gov.au/node/20627>

TNSPs reiterated that the guidelines and explanatory documentation should recognise the differences between distribution and transmission businesses.

DNSPs queried the next steps for the AER in developing/ refining the augex model ahead of reviews to commence next year, reflecting on consultation that had already taken place with the NSW DNSPs. AER staff undertook to confirm this.

Scope of the guidelines

Participants made several points regarding the level of prescription that could be in the guidelines:

- NSP representatives pointed to the non-binding nature of the guideline and the benefits of prescription, for example in providing interpretation or reasoning in how techniques related to NER provisions
- User representatives considered the guidelines should not be prescriptive. The example of the Statement of Regulatory Intent in the context of the rate of return was noted.
- The ACCC's Statement of Regulatory Principles was also noted as a potentially good example of the balance between prescription and flexibility, particularly with respect to its coverage of processes.
- If the AER was more certain on a particular approach (i.e. reflected a well-established precedent) the risk of prescribing this in the guideline may be small.
- The guidelines could reflect a consolidated statement from the AER and drafted such that stakeholders would not need to refer to previous AER decisions to understand its assessment approach.
- The life of the guidelines was raised as a potentially relevant factor. A guideline with a shorter expected life may be more or less prescriptive given the certainty around particular aspects at the time.

Participants discussed the notion of principles for the use and weighting of techniques. In particular:

- The guidelines could consider when these principles would be applied, for example at the Framework and Approach stage.
- Whether the principles would lead to a decision on how techniques would be used, for example in an informative sense or for screening purposes/ as a trigger for more detailed assessment.
- Whether the guidelines would specify criteria applicable for individual techniques, including thresholds or validation outcomes.

The weighting to be applied to the AER's Benchmarking Reports was also questioned, in particular concerns around this being relied upon too heavily in the AER's expenditure decisions given its likely prominence.

NSP representatives suggested that the guidelines provide some certainty around the design of incentives and potential tailoring of approaches, including principles for preserving penalties and rewards and recognition of such payments as a reflection of efficiency of outturn expenditures. The guidelines should consider whether efficiency is a "frontier" or "average" notion. This is particularly important when considering the rate of productivity change, and whether past productivity gains may

be expected to continue into the future. One NSP representative stated the proposed approach to forecasting productivity should be more transparent than the AER's previous approach.

It was suggested that the guidelines contain a menu of tools and explain how these might map to the NSP's proposal. This may allow NSPs to cater proposals to satisfy the AER's assessment approach, including guidance on how much effort NSPs should apply to particular issues/ techniques. The guidelines may benefit from a decision tree/ process specification, including on the "first pass" assessment to focus stakeholders on particular AER concerns. NSP representatives noted that techniques will produce a range of outcomes and are not precise.

User representatives noted that prescription in the guidelines in such cases may create problems where techniques indicate a NSP is efficient at a first pass, when more detailed review would indicate they are actually inefficient. They also noted the importance of using historic information to benchmark forecasts.

It was noted that the likely weight to be applied on certain techniques would change over time, for example as better or new data were obtained. The guidelines would need to provide for a consideration of a variety of techniques to avoid cherry-picking of outcomes, and also outline a process for reconciling any differences in the results of techniques. Stakeholders considered the possibility of the AER specifying qualitative weighting on techniques.

Expenditure setting process

User representatives questioned how consumers would be engaged in the first pass assessment approach. Stakeholders made the following points about this:

- NSPs would be required to consult with consumers in preparing their regulatory proposals. For this to be effective, consumers needed full access to relevant information on NSP performance and expenditures.
- The AER does not have a standard model to engage specifically with customers at each reset. In this context, the example of the Consumer Reference Group as part of the Better Regulation program was noted, as well as the role of the new Consumer Challenge Panel.
- The prevalence of ad hoc information exchanges between NSPs and the AER following the submission of regulatory proposals. Logs were kept of these exchanges for review however consumers have little to no visibility of them or the further information provided by NSPs. Some of this information may not be of interest to consumers and there was scope for the AER to consider how material information would be communicated to all stakeholders.

It was noted that the standard expenditure assessment process would involve NSPs submitting proposals in the knowledge of the AER's benchmarking methods and access to benchmarking data.

Implementation issues

NSP representatives made several points about information requirements:

- It would be helpful if the guidelines recognised the change in reporting requirements, including the existence of the TNSP Submission Guidelines
- Whether and how the Framework and Approach stage will be used to refine information requirements

- The value of the guidelines containing specific data requirements in order to develop and present business cases to NSP Boards to implement changes to reporting systems
- The lead time involved in complying with information instruments
- That any new or changed requirements in the Framework and Approach stage would be too late for NSPs to accommodate in submitting proposals.

User representatives questioned the process by which various implementation issues would be resolved. AER staff noted that many of these were still under consideration and would be addressed in the draft guidelines. The materiality of some issues was dependent on the specific data to be requested. This information would be expressed in indicative RIN/RIO templates to be issued in August 2013 with the draft guidelines.

It was noted that NSPs submitting proposals in 2014 would be doing so prior to the collection and analysis of new benchmarking data. AER staff reiterated that there would need to be a process of consultation with the sector from the point these data were submitted and prior to making draft decisions and the AER first benchmarking report in late 2014. It was noted that all NSPs would have a stake in this process, not just those subject to reviews.

AER staff noted that there would be a process of data collection and model validation for economic benchmarking techniques. This was welcomed by stakeholders.

Attachment A: Attendee list

Melbourne office

Name	Organisation
David Dawson	Strategic Economics Consulting Group
David Headberry	Major Energy Users
Mark Henley	Uniting Communities
Bill Jackson	ElectraNet
Andrew Kingsmill	TransGrid
Michael Seddon	Transend
Rob McMillan	Jemena
Anh Mai	SP AusNet
Jeremy Rothfield	United Energy and MultiNet Gas
Leigh Mayne	Aurora
Scott Stacey	Incenta
Garth Crawford	ENA
Peter Bucki	Envestra
Renate Tirpcou	Citipower/ Powercor
Eric Lindner	SA Power Networks
Nicola Roscoe	Energex
Andrew Reeves	AER
Lawrence Irlam	AER
Mark McLeish	AER
Anthony Seipolt	AER
Toby Holder	AER
Esmond Smith	AER
Andrew Ley	AER
Jess Manahan	AER
Sam Sutton	AER
Kevin Cheung	AER
Max Hooper	AER

Sydney office

Name	Organisation
Alex Curran	APA Group
Brendon Crown	Ergon Energy
Ed King	Ausgrid
Matt Cooper	Ausgrid
Rick Wallace	Endeavour Energy
Cathy Waddell	Essential Energy
Matt Le Cornu	AER
Andrew Barram	AER