Issues paper

AER standardised model for Standard Control Services capital expenditure

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AUSTRALIAN ENERGY REGULATOR

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Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
ANS	Ancillary Network Services
capex	Capital expenditure
distributor	Distribution network service provider
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
PTRM	Post tax revenue model
RAB	Regulatory Asset Base
RIN	Regulatory Information Notice
SCS	Standard Control Services

1 About this issues paper

The Australian Energy Regulator (AER) is developing a standardised Standard Control Service (SCS) capital expenditure (capex) model to use in future electricity distribution determinations. The standardised SCS capex model is intended to replace the distribution network service provider (distributor)-specific capex models that are currently in use.

The development and implementation of a standardised SCS capex model follows our commitment in the AER Strategic Plan 2020–2025 to design our systems to work in ways that deliver efficient regulation of monopoly infrastructure.[1]

Capex models map forecast capex into a format that is consistent with the post-tax revenue model (PTRM) in order to calculate the annual revenue requirement for each year of a regulatory control period. A standardised SCS capex model seeks to streamline the resources and consultation required to review and manage the SCS capex models, and increase consistency across proposals.

This issues paper sets out some key areas of consideration in developing the standardised SCS capex model. We are seeking industry feedback on these, including the accompanying preliminary standardised SCS capex model. We will address other aspects outside the scope of this issues paper, such as changes to our Regulatory Information Notices (RINs), separately.

A separate process is currently planned for the development of the standardised Ancillary Network Services (ANS) model, which stakeholders can provide comments on in the future.

[1] AER, AER strategic plan 2020–2025, December 2020, p.9

2 Invitation for submissions

Written submissions from interested stakeholders are invited by 30 August 2021. We will consider all submissions received by that date. Submissions should be in Microsoft Word or another machine-readable document format. Please address submissions to:

StandardSCSCapexModel@aer.gov.au

Sebastian Roberts
General Manager – Expenditure
Australian Energy Regulator

We prefer that all submissions are publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. All non-confidential submissions will be placed on our website. Parties wishing to submit confidential information should:

- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission in a form suitable for publication.

Consultation process

After we have reviewed the submissions, we intend to host a workshop/s where we will discuss the key issues from the submissions. Following the workshop/s, we will have regard to all stakeholder comments (in written submission and in the workshop) to develop a final model with an explanatory note.

Table 1 Indicative consultation timeframes

Key steps	Indicative dates
Publish issues paper	2 August 2021
Submissions due	30 August 2021
Workshop	13 September 2021
Publish explanatory note	late 2021

3 Background

The AER is the independent regulator for Australia's national energy market (NEM). We regulate energy networks in all jurisdictions except Western Australia. We set the amount of revenue that network businesses can recover from customers for using these networks.

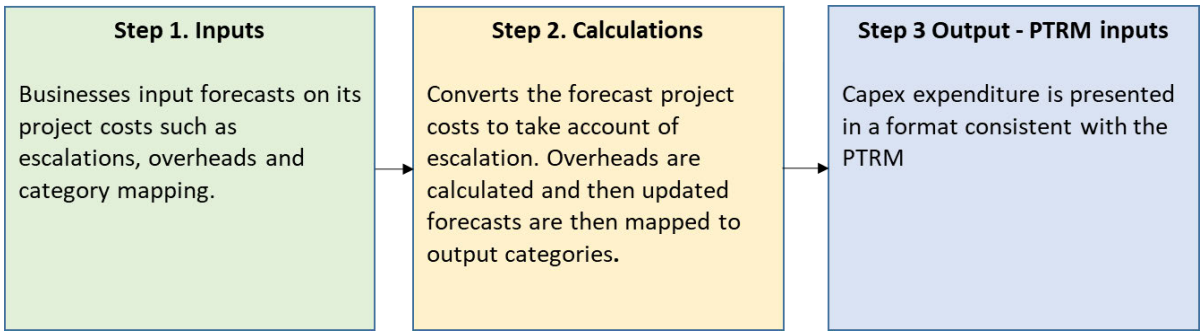
The National Electricity Law and Rules (NEL and NER) provide the regulatory framework governing electricity distribution networks. Our work under this framework is guided by the National Electricity Objective (NEO).[2]

At a revenue review, a distributor proposes a total capex forecast that it considers is required in order to achieve the capex objectives.[3] Capex is added to a distributor's Regulatory Asset Base (RAB), which is used to determine the return on capital and return of capital (regulatory depreciation) building block allowances.

Under the NER, the AER is required to prepare a PTRM that calculates the annual revenue requirement for each regulatory year of a regulatory period.[4] A distributor's revenue proposal must be prepared using our PTRM.[5]

The process of categorising and mapping proposed capex programs and projects into a PTRM is typically achieved using capex models. While multiple distributor-specific capex models are currently in use, all capex models typically share common modelling processes including inputs, calculations and outputs in order to categorise and map capex projects to PTRM output categories. Figure 1 is a diagram of a typical capex model.

Figure 1 – Diagram of a typical capex model



2 NEL, s. 7.
3 NER cl. 6.5.7(a)
4 NER cl. 6.4.2
5 NER, cll. 6A.4.1(b)(1) and 6.3.1(c)(1)

4 A standardised SCS capex model

Our intention is to develop a standardised SCS capex model that will reduce the resources required to review and manage these models by:

- streamlining the process of mapping proposed capex into PTRM categories;
- improving quality assurance processes.

A standardised SCS capex model will also increase regulatory certainty through a consistent treatment of capex data across determinations.

For these benefits to be fully realised, the standardised SCS capex model needs to be "fit-for-purpose". In this regard, we view industry feedback as a critical part of the process to developing a standardised SCS capex model.

As a first step, we have developed a preliminary standardised SCS capex model to reflect the common core functions of the distributor-specific capex models. In developing the preliminary standardised SCS capex model, we considered existing distributor-specific capex models, recent electricity distribution determination decisions and future electricity distribution determinations. The preliminary standardised SCS capex model standardises selected high level (non-project specific) aspects of the SCS capex models such as overheads and CPI by having a default methodology that businesses can override if required.

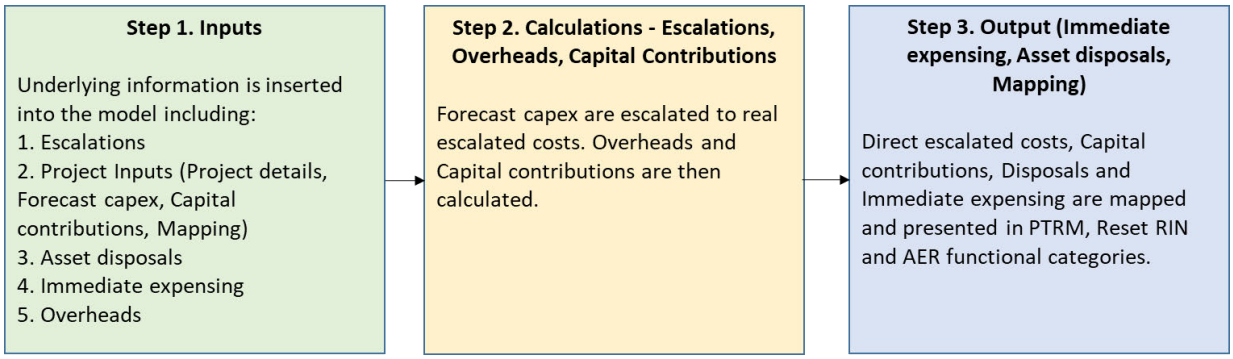
The preliminary standardised SCS capex model is for consultation purposes only. We appreciate that it does not reflect all the unique circumstances for each business. This consultation process is intended to help us work through key areas of consideration we have identified. Stakeholders are also welcome to raise other areas of consideration not identified in this issues paper.

Having regard to stakeholder comments, we intend to have a series of workshops to collectively work through the specific issues raised. Following the consultation process, the standardised SCS capex model will be updated and finalised and published with an explanatory note.

Preliminary standardised SCS capex model

Figure 2 shows the preliminary standardised SCS capex model's layout and how it incorporates the core functions of a typical capex model.

Figure 2 – AER preliminary standardised SCS capex model



Step 1 requires businesses to input the data used to derive its capex forecast into the model.

Step 2 uses most of the input data to calculate escalated forecasts, overheads and capital contributions. Overheads are forecast using historical data or directly entered by the business and allocated to projects on a direct costs basis. Capital contributions are allocated to projects based on the percentage of direct costs input by the business.

Step 3 maps the updated forecast capex to output categories consistent with the PTRM, Reset RIN and AER assessment. Gifted assets are removed from the PTRM inputs to obtain gross capex and immediate expensing is calculated from gross capex. Revenue from asset disposals are excluded along with capital contributions to obtain net capex.

We had regard to the following factors when developing the preliminary standardised SCS model:

1. Inflation
    a. In our decisions we use the same CPI series as per our roll-forward model; that is, using a 12-month lag. We encourage distributors to use this methodology when inputting CPI.
    b. The preliminary standardised SCS capex model allows users to select a base year for unescalated direct cost inputs to be escalated to the regulatory base year.
2. Real price escalation
    a. Consistent with our recent decisions, the preliminary standardised SCS capex model allows for labour cost escalations and does not include contract services or materials escalation.[6]
3. Project inputs
    a. The project input sheets contains forecast capex as well as inputs for internal labour escalations, capital contributions, category mapping and allocation of capitalised overheads.

[6] AER, Draft decision Powercor distribution determination 2021–26, Attachment 5 – Capital expenditure , September 2020, p.14

4. Gifted assets
    a. In October 2020, the Federal Court of Australia published a decision that confirms that cash contributions should be treated as assessable income for income tax purposes.[7] The preliminary standardised SCS capex model includes gifted assets as an input to assist reconciliation with the RINs and historical data and for error checking purposes. Gifted assets will not contribute to gross capex in our reset decisions.
5. Capitalised overheads
    a. The preliminary standardised SCS capex model is set up in a way which prescribes a methodology for forecasting capitalised overheads:
        i. Capitalised overheads are forecast by taking capitalised overheads for the current period as a starting point and adjusting them up or down in proportion to forecast direct costs. The proportionality factor is 25 per cent, which is the same as our standard approach for adjusting capitalised overheads in our recent decisions.[8]
        ii. Capitalised overheads are then allocated to project codes that the distributor has identified as attracting overheads, on a direct project cost to total direct capex basis.
    b. Alternatively, distributors are free to directly enter forecast capitalised overheads. In this case, overheads will still be allocated on a direct project cost to total direct capex basis as described above.
6. Outputs
    a. The preliminary standardised SCS capex model produces three separate outputs: PTRM categories, Reset RIN categories and AER functional categories.
        i. Mapping to the Reset RIN categories will ensure consistency and limit the need for information requests to rectify data reconciliation issues. We will update the mapping after we finalise our RIN review. In our review we will aim to align the high-level Reset RIN categories with AER functional categories.
        ii. Mapping to AER function categories will increase the efficiency and consistency of our assessments and processes. The AER function categories reflect the current way we assess capex proposals.
7. Dual function and transmission assets
    a. We will work with distributors independently to ensure that the model accommodates their requirements for forecasting and mapping dual function and transmission assets.

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7 Victoria Power Networks Pty Ltd v Commissioner of Taxation [2020] FCAFC 169

8 In our capex decisions, we typically assume that 75 per cent of forecast capitalised overheads are fixed and 25 per cent vary with changes to direct capex.

Invitation for submissions

We are seeking feedback from stakeholders on the preliminary standardised SCS capex model. In particular, we are interested in hearing your views about the functions of the model, including:

- whether you think the model needs more or less functions
- whether the functions in the model are fit for purpose, transparent and can be adopted by industry.

We also welcome feedback on any other issues relating to the preliminary standardised SCS capex model.

In your submissions, we encourage stakeholders to provide examples or explanations that support the issues raised. This will help us to make improvements so that the final version of the standardised SCS capex model is more usable for both the businesses and the AER.

We also appreciate that it may be more constructive to demonstrate your point by going through the preliminary standardised SCS capex model (or your own model) with us. In that circumstance, please contact StandardSCSCapexModel@aer.gov.au and we will arrange a time to discuss.