



**Transmission draft decision**

**ElectraNet**

**1 July 2013 to 30 June 2018**

**Mr Andrew Reeves**

**Chairman**

**12 December 2012**

# Framework

- The AER is responsible for the economic regulation of electricity transmission services. The AER's draft decision for transmission under the National Electricity Rules (NER) chapter 6A has four elements:
  - Prescribed services
    - revenue decision
    - pricing methodology
  - Negotiated services
    - negotiating framework
    - negotiated Transmission Services Criteria (NTSC)
- Other chapter 6A rules concerned with contingent projects, service standards, efficiency benefit sharing scheme

# Specialist advice

- Energy Market Consulting associates and Strata Energy Consulting
  - forecast capex (including contingent projects), opex and service standards targets
- Energy Market Consulting associates and NZIER
  - demand forecasting review
- Deloitte Access Economics
  - forecast labour cost growth
  - productivity measures to adjust labour price index and average weekly ordinary time earnings

# Engagement & Consultation

- Public forum hosted by AER
- Stakeholder submissions
- Stakeholder meetings
- On-site visits to ElectraNet
- Detailed information requests & responses
- Workshops with ElectraNet

# Key differences

- The key differences between ElectraNet and the AER are:
  - Opening RAB
  - Demand forecast
  - Capex
  - Cost of capital – timing difference, agreement on assumptions
  - Opex

# Revenue

Capital costs

Return on capital  
(forecast regulatory asset base × cost  
of capital)

Regulatory depreciation (depreciation  
net of indexation applied to regulatory  
asset base)

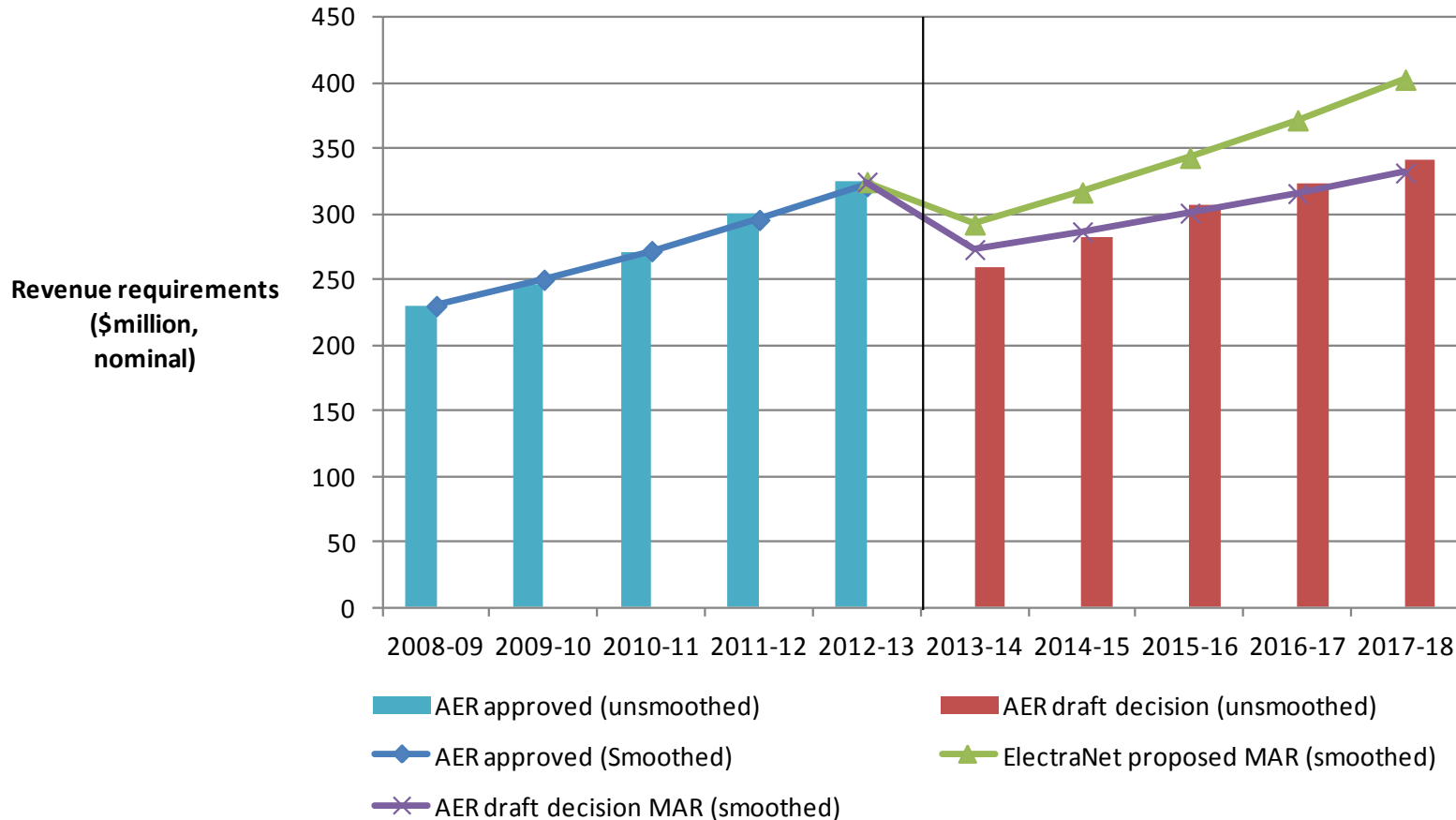
Corporate income tax (net of value of  
imputation credits)

Operating expenditure (opex)

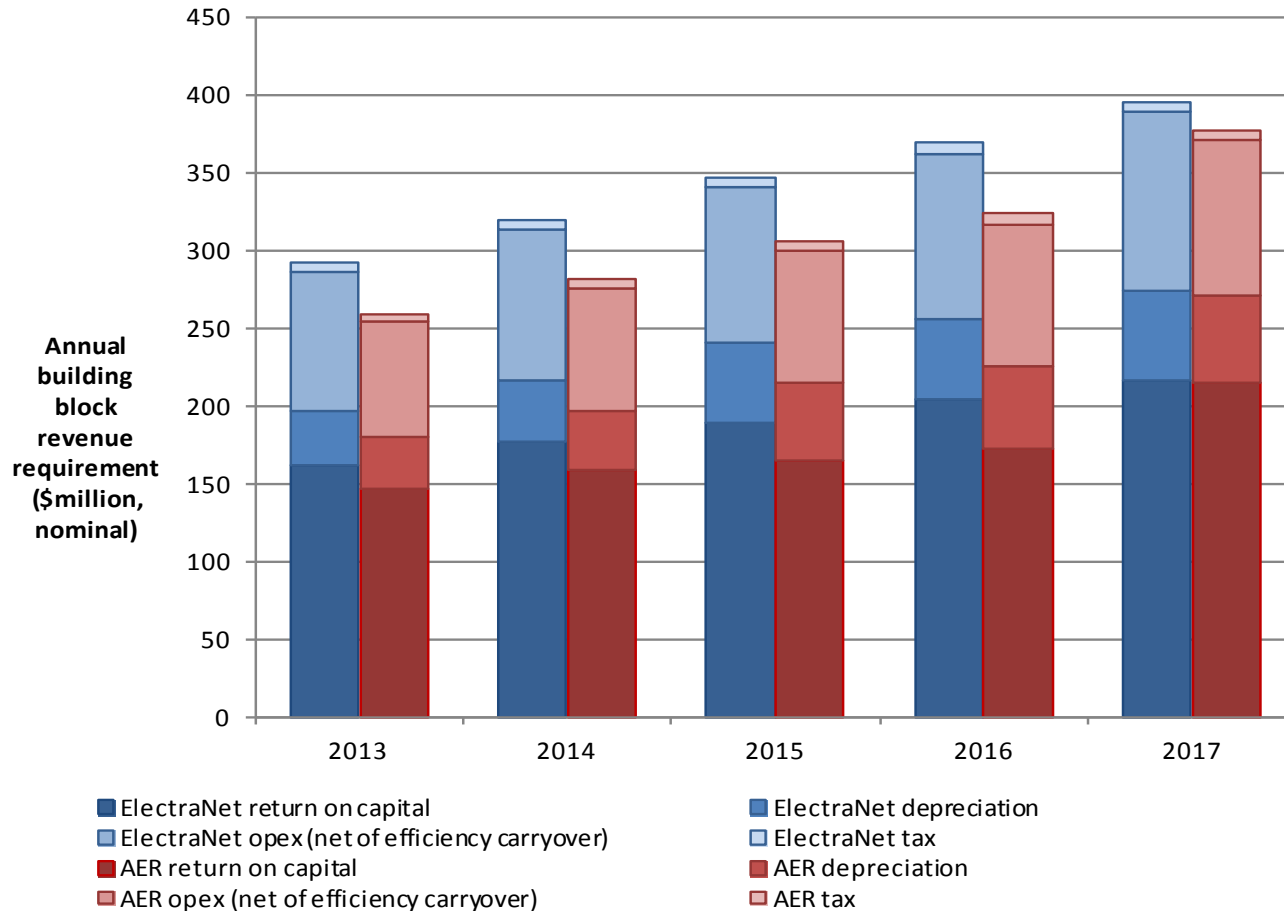
Efficiency benefit sharing scheme  
(increment or decrement)

Total revenue

# Revenue

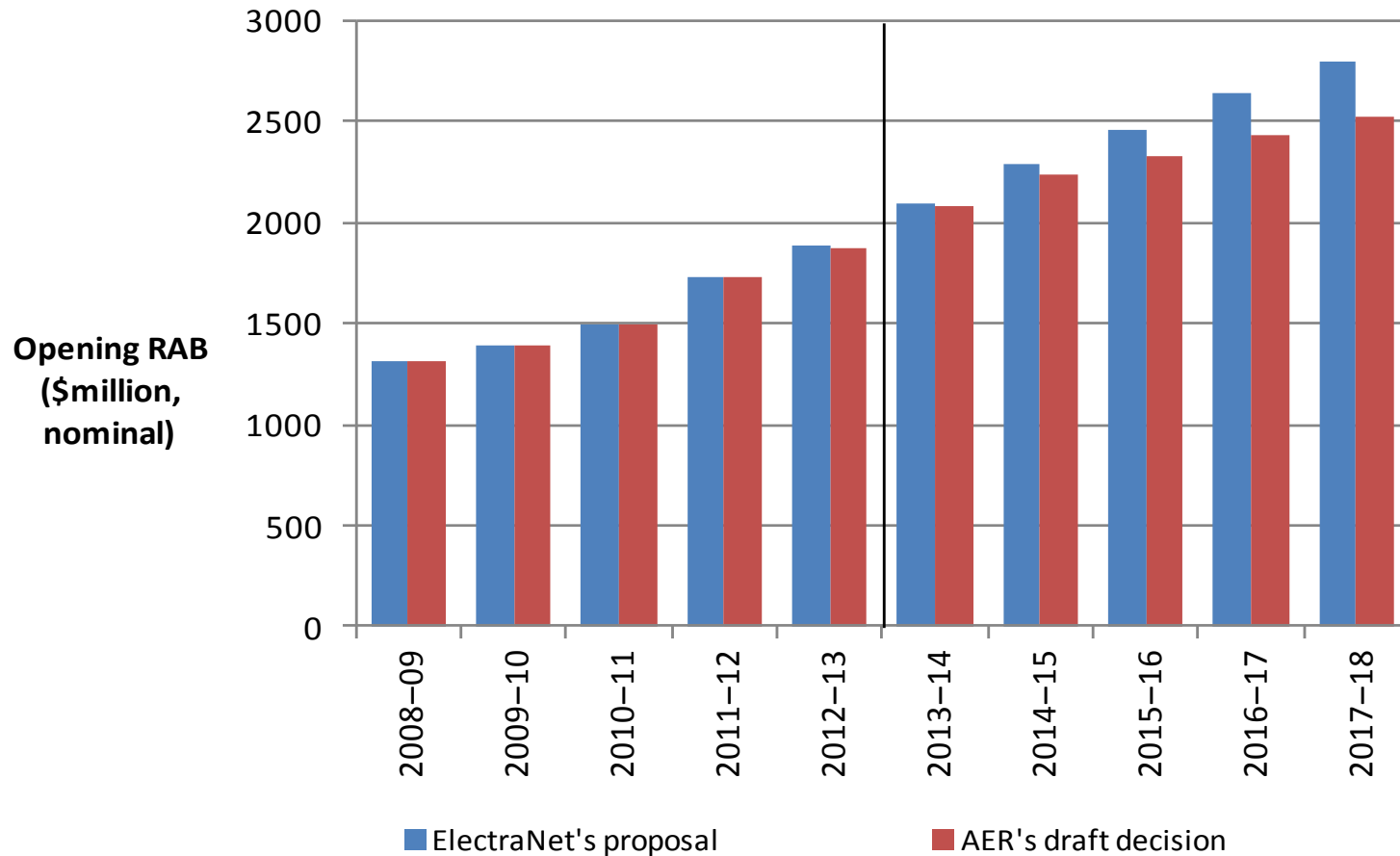


# Annual building block revenue





# Regulatory asset base



# Regulatory asset base

## ElectraNet proposal

- Opening RAB in July 2013 is \$2100m
- Closing RAB in June 2018 is \$2861m
- 36 per cent increase during the regulatory control period

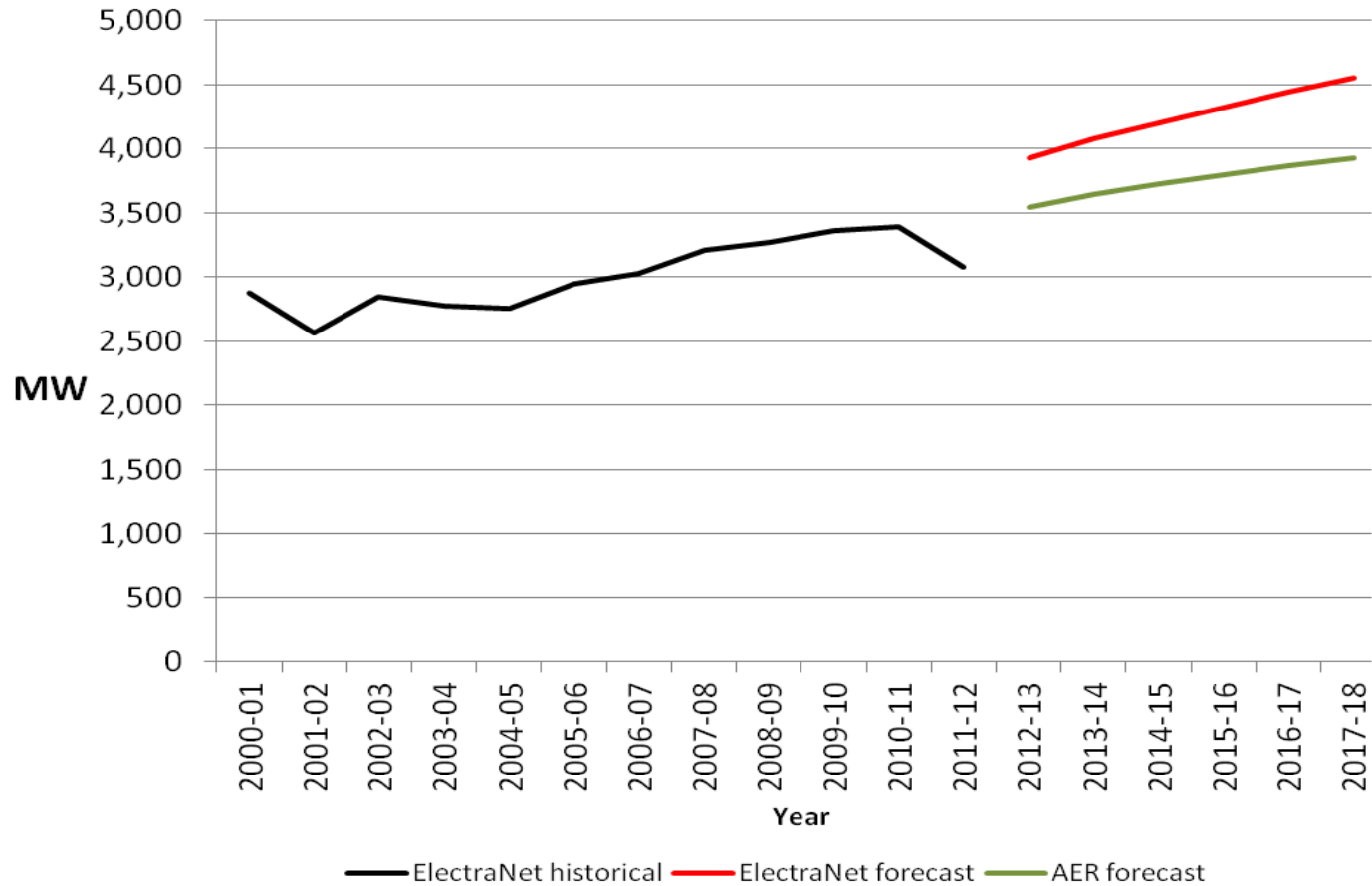
## AER draft decision

- Opening RAB in July 2013 is \$2078m
- Closing RAB in June 2018 is \$2560m
- 23 per cent increase during the regulatory period

## Key reasons

- Lower opening RAB as at July 2013, mainly driven by correcting input errors in the model
- Reduced forecast capex

# Demand forecasts



# Demand forecasts

## ElectraNet proposal

- 4077 MW (2013-14) to 4553 MW (2017-18)

## AER draft decision

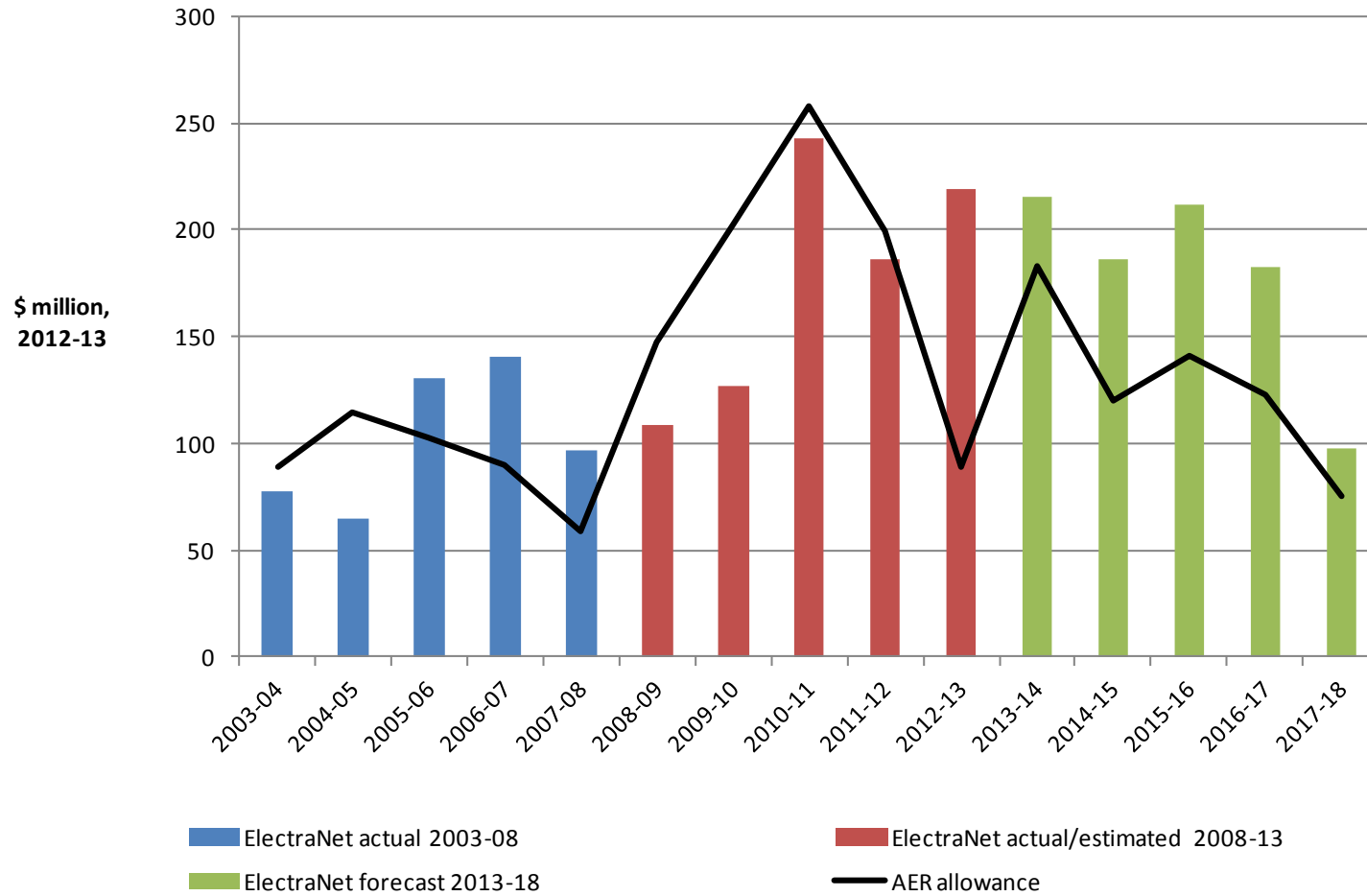
- 3644 MW (2013-14) to 3928 MW (2017-18)
- The AER's demand forecast is lower by 433 MW (2013-14) to 625 MW (2017-18)

## Reasons

The AER considers ElectraNet's demand forecast:

- did not reflect temperature fluctuations
- did not appropriately account for PV generation, embedded generation and demand response
- did not apply a diversity factor
- was not reconciled to a top down econometric forecast.

# Capex allowance



# Capex allowance

## ElectraNet proposal

- \$894 million (\$2012-13)

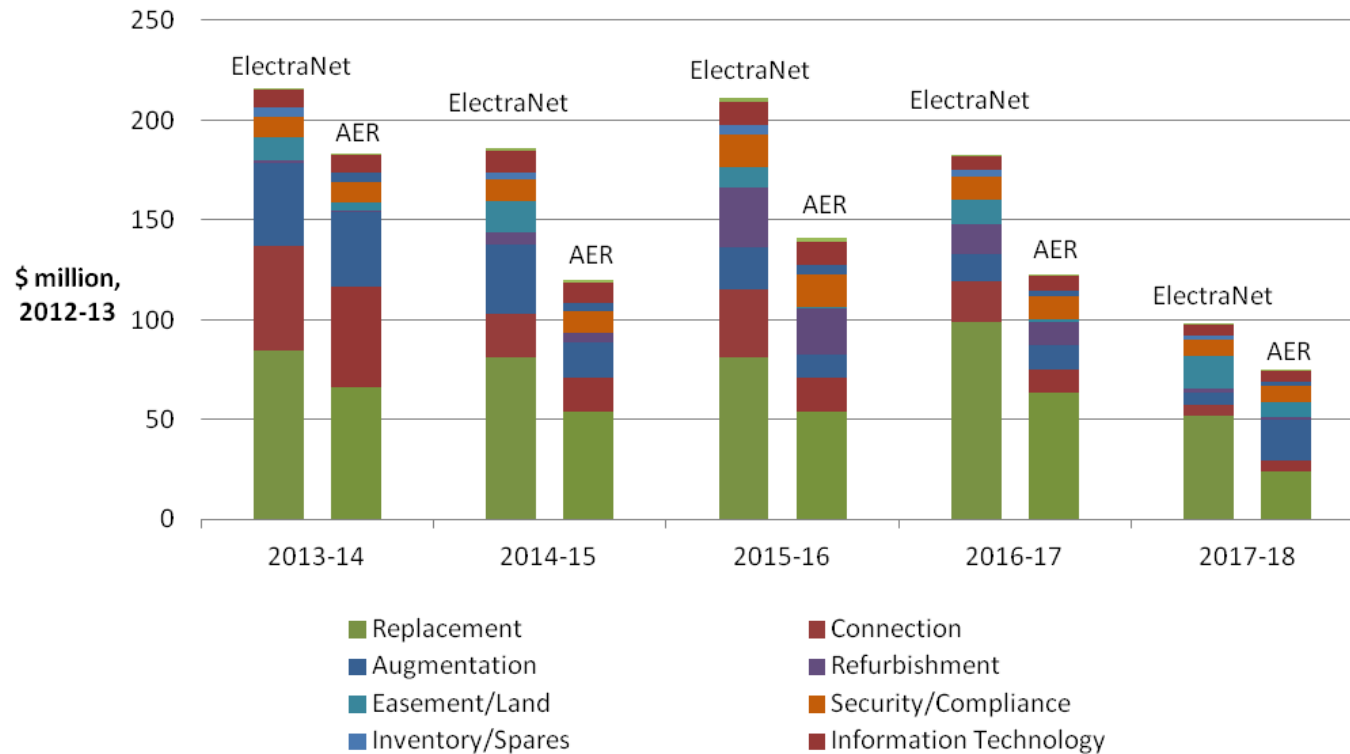
## AER draft decision

- \$641.9 million (\$2012-13)
- decrease of 28 per cent

## Key adjustments

- load driven capex—\$103.7 million.
- cost estimation risk factor—\$19.6 million
- replacement and refurbishment capex—\$81.8 million
- real cost escalation—\$9.3 million
- strategic land and easement acquisitions—\$51.4 million

# Capex allowance



# Contingent projects

- ElectraNet proposed 21 projects valued at \$2.5 billion
- The AER did not accept the projects – not fully compliant with NER
  - 5 projects compliant subject to refining the trigger events – valued at \$666 million
  - Projects associated with general load growth – not accepted
  - Projects that are not probable – not accepted



# Cost of capital

## ElectraNet proposal

- 7.73 per cent

## AER draft decision

- 7.11 per cent
- Market based parameters to be updated at final decision

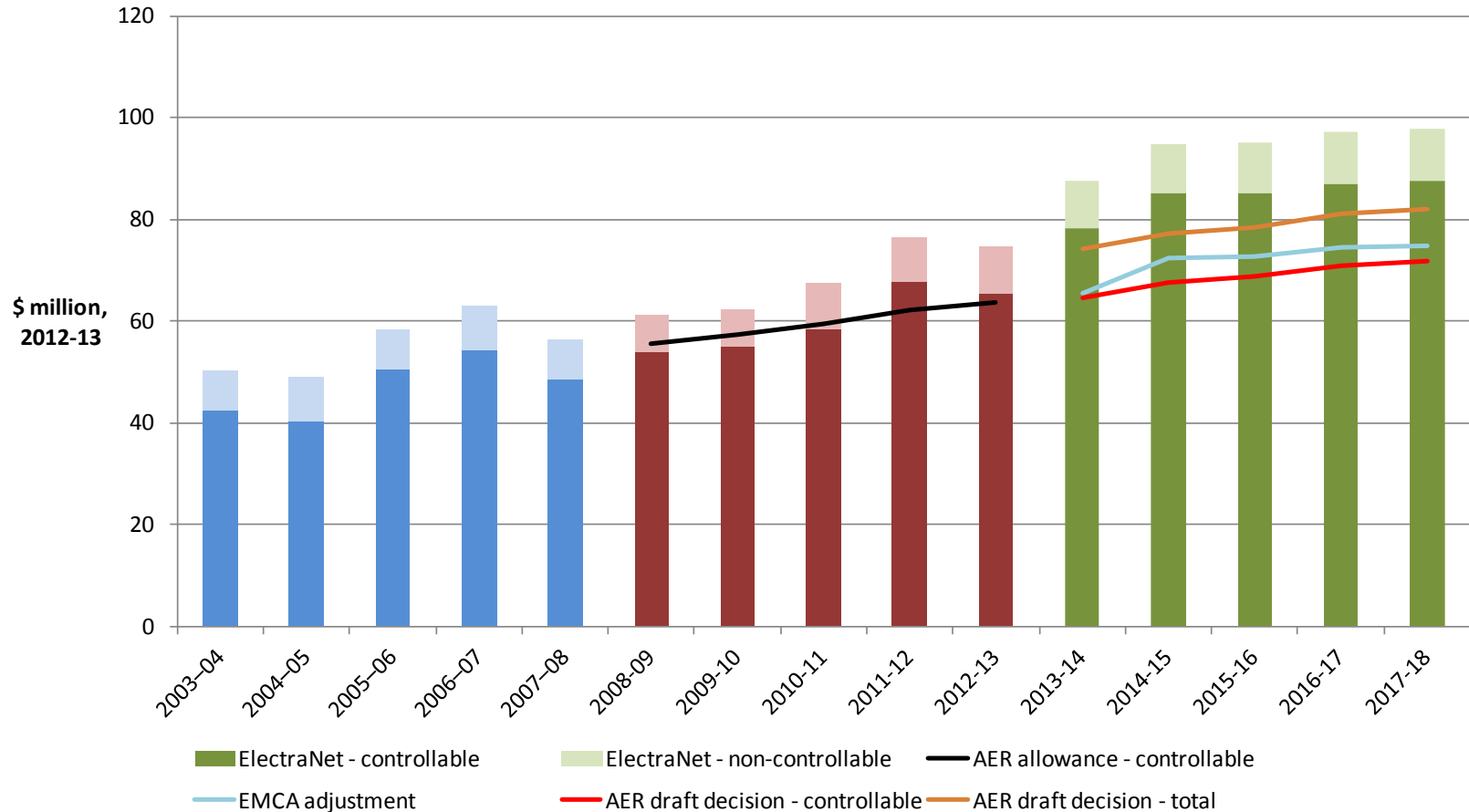
## Reasons

- AER accepts ElectraNet's proposed method.
- Lower WACC due to market based parameters—the nominal risk free rate and the debt risk premium (DRP)
- These have been estimated over a more recent (indicative) averaging period.

# Cost of capital

<b>WACC parameters</b>	<b>ElectraNet's proposal</b>	<b>AER's draft decision</b>
Nominal risk free rate (per cent)	3.26	3.03
Equity beta	0.8	0.8
Market risk premium (per cent)	6.50	6.50
Gearing level (debt/debt plus equity) (per cent)	60	60
Debt risk premium (per cent)	3.98	3.34
Assumed utilisation of imputation credits (gamma)	0.65	0.65
Inflation forecast (per cent)	2.50	2.50
Cost of equity (per cent)	8.46	8.23
Cost of debt (per cent)	7.24	6.37
<b>Nominal vanilla WACC (per cent)</b>	<b>7.73</b>	<b>7.11</b>

# Opex allowance



# Opex allowance

## ElectraNet proposal

- \$478.1 million (\$2012-13)
- 40 per cent increase (real) on current

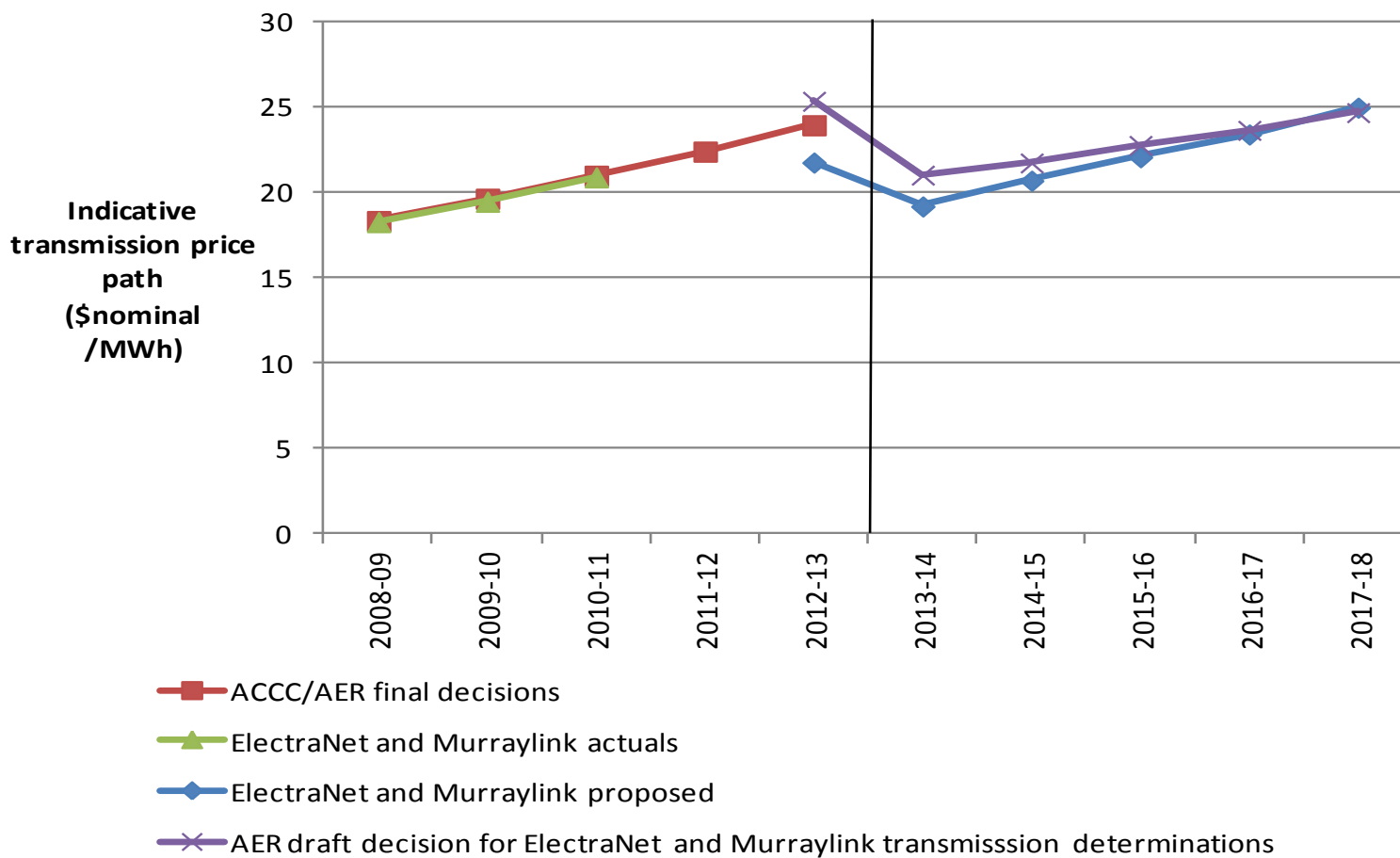
## AER draft decision

- \$397.6 million (\$2012-13)
- 17 per cent increase (real) on current

## Key reasons

- base year
- step changes
- network optimisation
- network growth escalators and economies of scale
- opex efficiency factor

# Indicative price path



# Service target performance incentive scheme (STPIS)

## Service component

- financial incentive to maintain and improve performance
- limited to 1 per cent of maximum allowed revenue (MAR)
- financial reward/penalty for good/poor performance

## Market component

- financial rewards for improvements in performance
- additional revenue increment of up to two per cent of MAR
- no financial penalty for underperformance

# Service target performance incentive scheme (STPIS)

Parameter	Collar	Target	Cap	Revenue Weighting
Transmission circuit availability (%)	99.02	99.52	99.68	0.3 %
Circuit availability – peak (%)	97.36	99.12	99.96	0.1 %
Circuit availability – off peak (%)	98.25	99.37	99.87	0.0 %
Loss of supply events > 0.05 system minutes	9	7	4	0.2 %
Loss of supply events > 0.2 system minutes	4	2	0	0.2 %
Average outage duration (mins)	323.2	203.2	83.2	0.2 %
Market impact component	-	1585	0	2.0 %

# Pricing methodology

- A pricing methodology is the methodology used to:
  - allocate the aggregate annual revenue requirement to categories of prescribed transmission services and transmission network connection points
  - determine tariff structure

## AER draft decision

- The AER approves ElectraNet's proposed pricing methodology



# Negotiated services

- Light-handed approach – minimum prescription, reliance on commercial negotiation between able counter parties
  - not subject to direct revenue control
  - commercial arbitration available if necessary
- Key elements to the negotiated transmission service regime:
  - negotiated transmission service principles
  - negotiating framework
  - negotiated transmission service criteria (NTSC)

# Negotiated services

## AER draft decision

- AER does not approve ElectraNet's proposed negotiating framework
- ElectraNet required to amend framework by including additional clauses

## Reasons

- The AER does not approve ElectraNet's proposed negotiating framework because it does not accurately specify the requirements of clause 6A.9.5(c) the NER.

# Process – next steps

16 January 2013	ElectraNet revised revenue proposal
19 February 2013	Submissions on revised proposal and draft decision
	Submissions to: <a href="mailto:AERInquiry@aer.gov.au">AERInquiry@aer.gov.au</a>
30 April 2013	AER final decision
1 July 2013	Start of regulatory control period

# Questions and comments