AUSTRALIAN ENERGY REGULATOR

Transmission draft decision

Murraylink

1 July 2013 to 30 June 2023

Mr Andrew Reeves

Chairman

12 December 2012

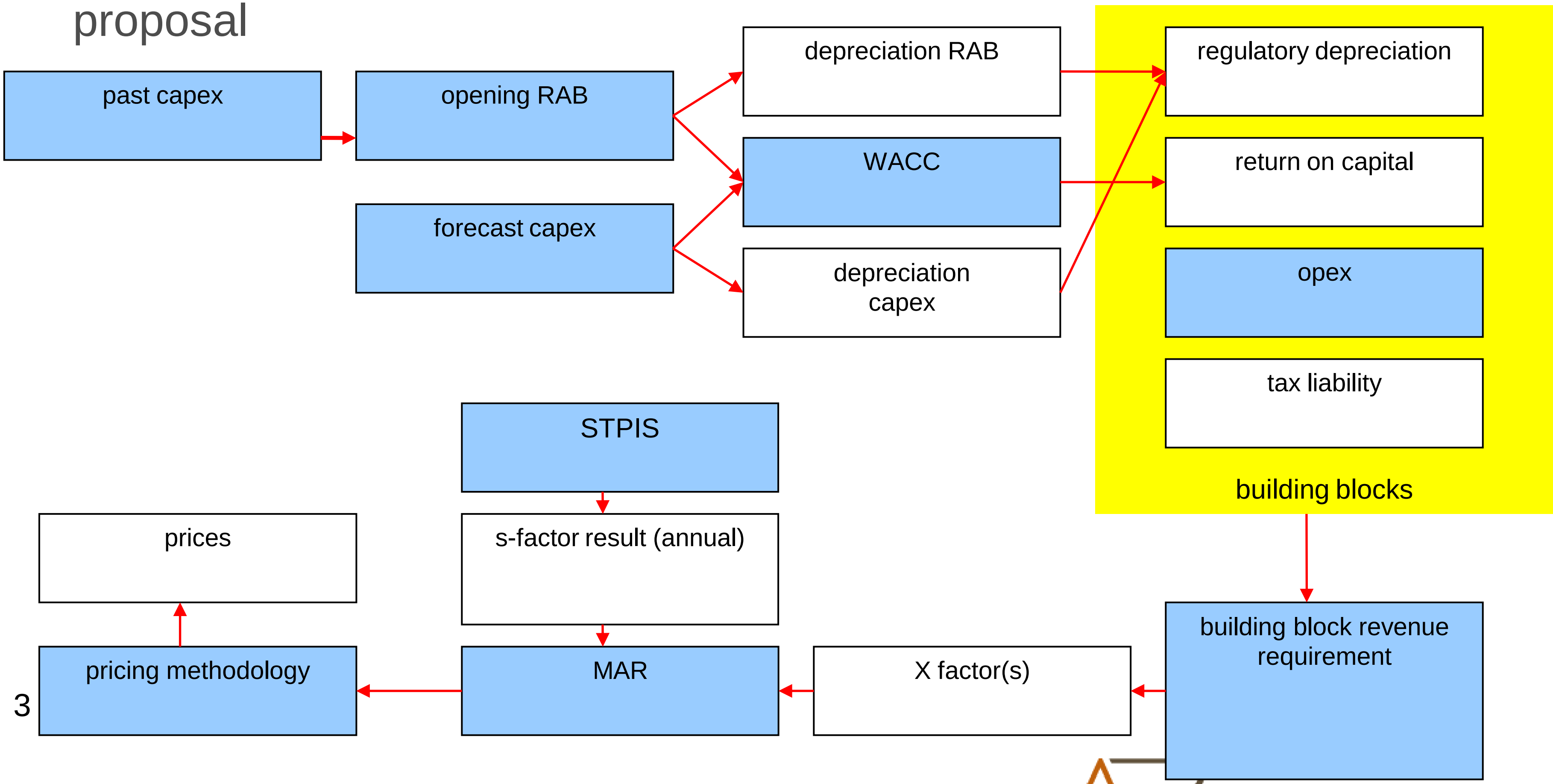
Specialist advice sought

- CHC Consulting
  - forecast capital expenditure (capex) and forecast operating expenditure

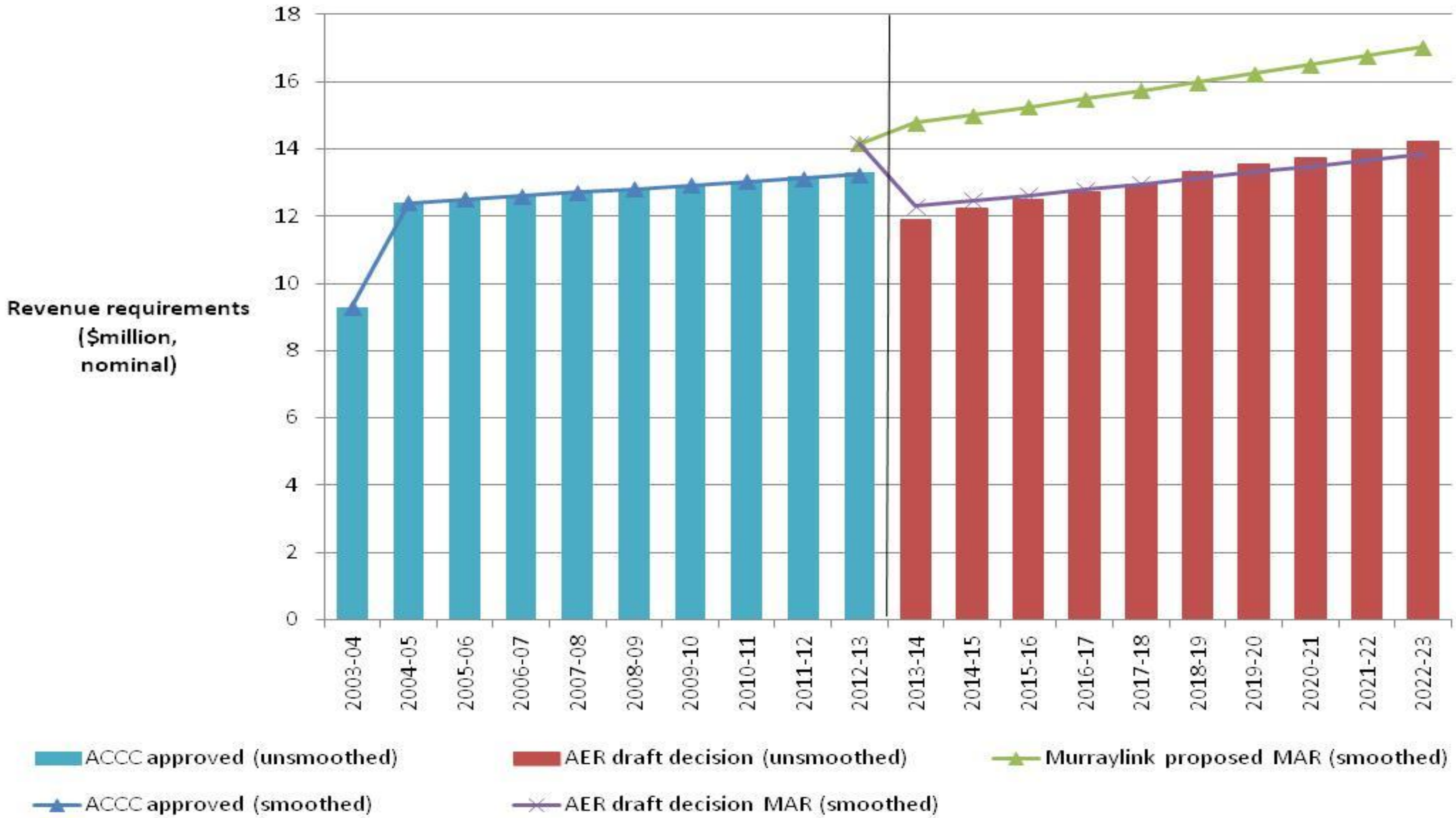
- Deloitte Access Economics
  - forecast labour cost growth
  - productivity measures: labour price index and average weekly ordinary time earnings

Revenue

- The revenue allowance is calculated from the following components
- The AER does not accept all elements of Murraylink's revenue proposal



Revenue



Note: The 2003-04 revenue figure reflects 9 months revenue.

Indicative prices

- The AER estimated average transmission price impacts on South Australian customers after accounting for both ElectraNet and Murraylink revenue proposals and draft decisions

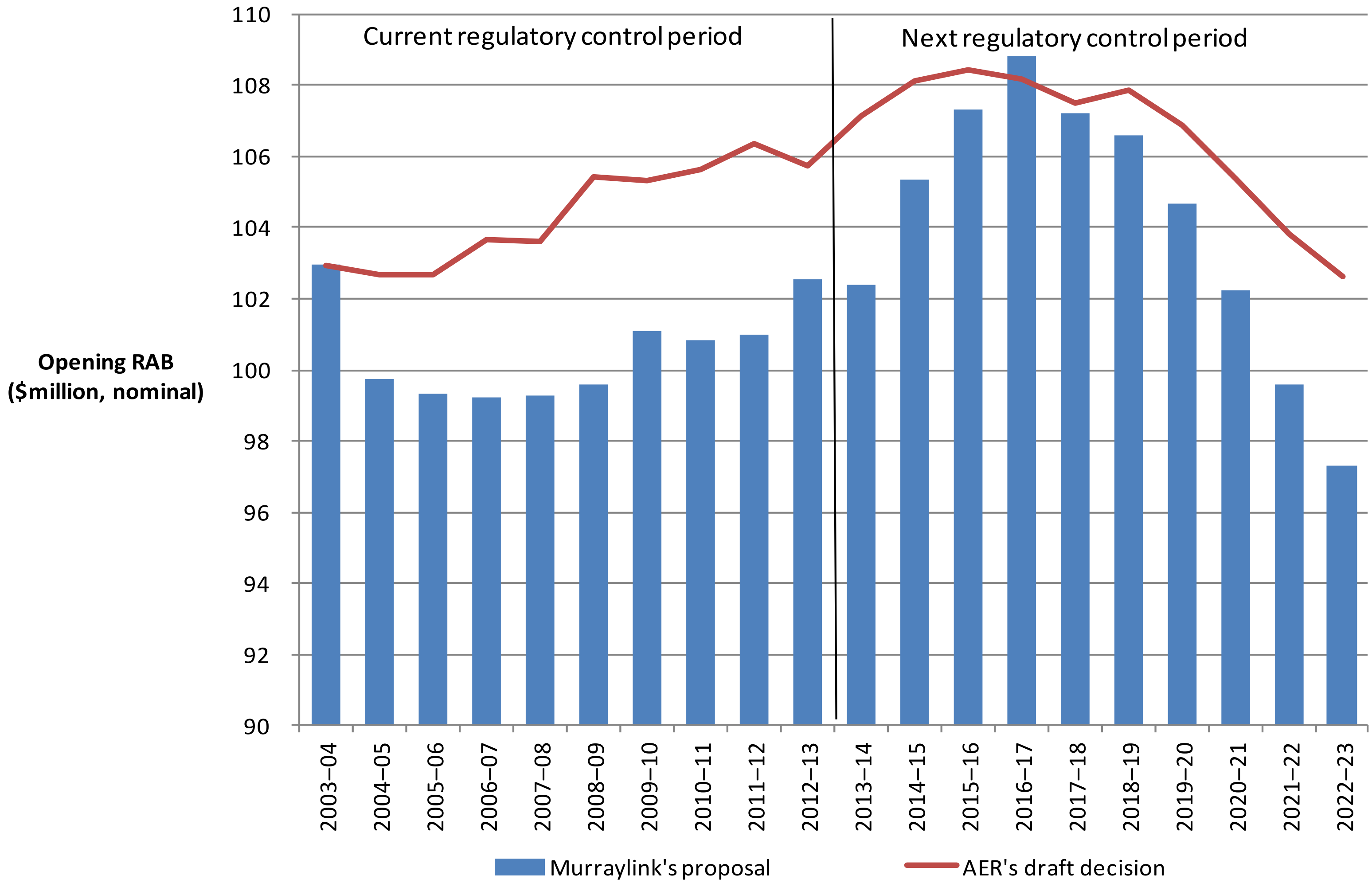
- If the draft decision were to become final:

  - no change to average residential and non-residential customers' bills

Difference between Murraylink proposal and AER draft decision

- WACC: lower WACC due to differences in the timing of sampling period, but no differences in methods
- Higher RAB due to: errors in inputs, partially offset by lesser depreciation allowance and AER rejection of certain capex
- Capex: lower capex primarily because 3 projects were unsubstantiated
- Opex: lower opex because some opex costs (contracted services) were unsubstantiated and base year costs were not efficient.

Regulatory asset base



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Regulatory asset base

Murraylink proposal

- Opening July 2013 RAB $102.4m
- Closing June 2023 RAB $95.9m
- 6 per cent decrease during the regulatory control period

AER draft decision

- Opening July 2013 RAB $107.1m
- Closing June 2023 RAB $102.0m
- 5 per cent decrease during the regulatory period

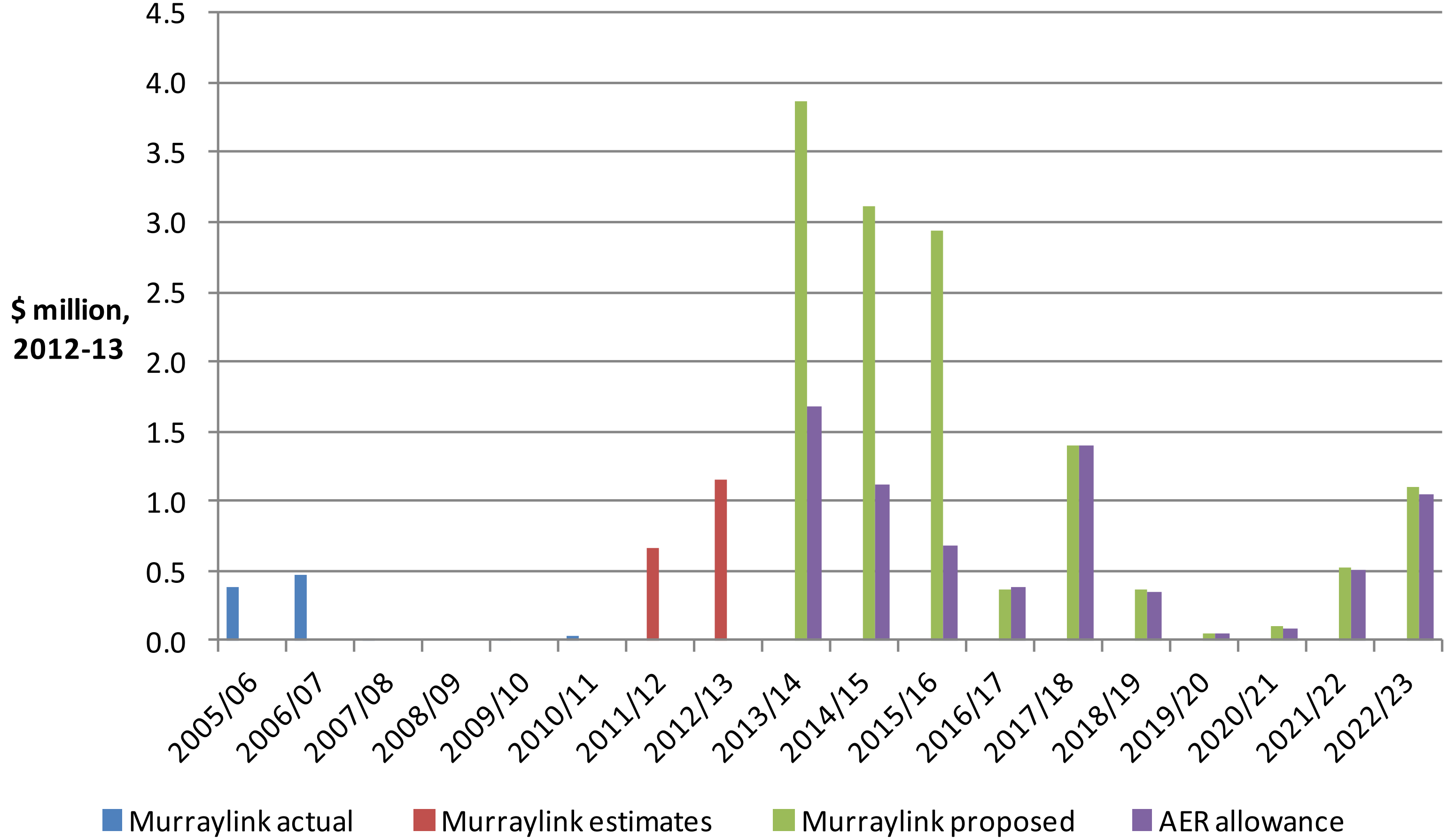
Key reasons

- Higher opening RAB as at July 2013, mainly driven by correcting input errors in the model
- Reduced forecast depreciation, driven by:

  - longer standard asset lives for several asset classes; and

  - lower capex forecast.

Capex allowance



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Capex allowance

Murraylink proposal

- $13.8 million ($2012-13)

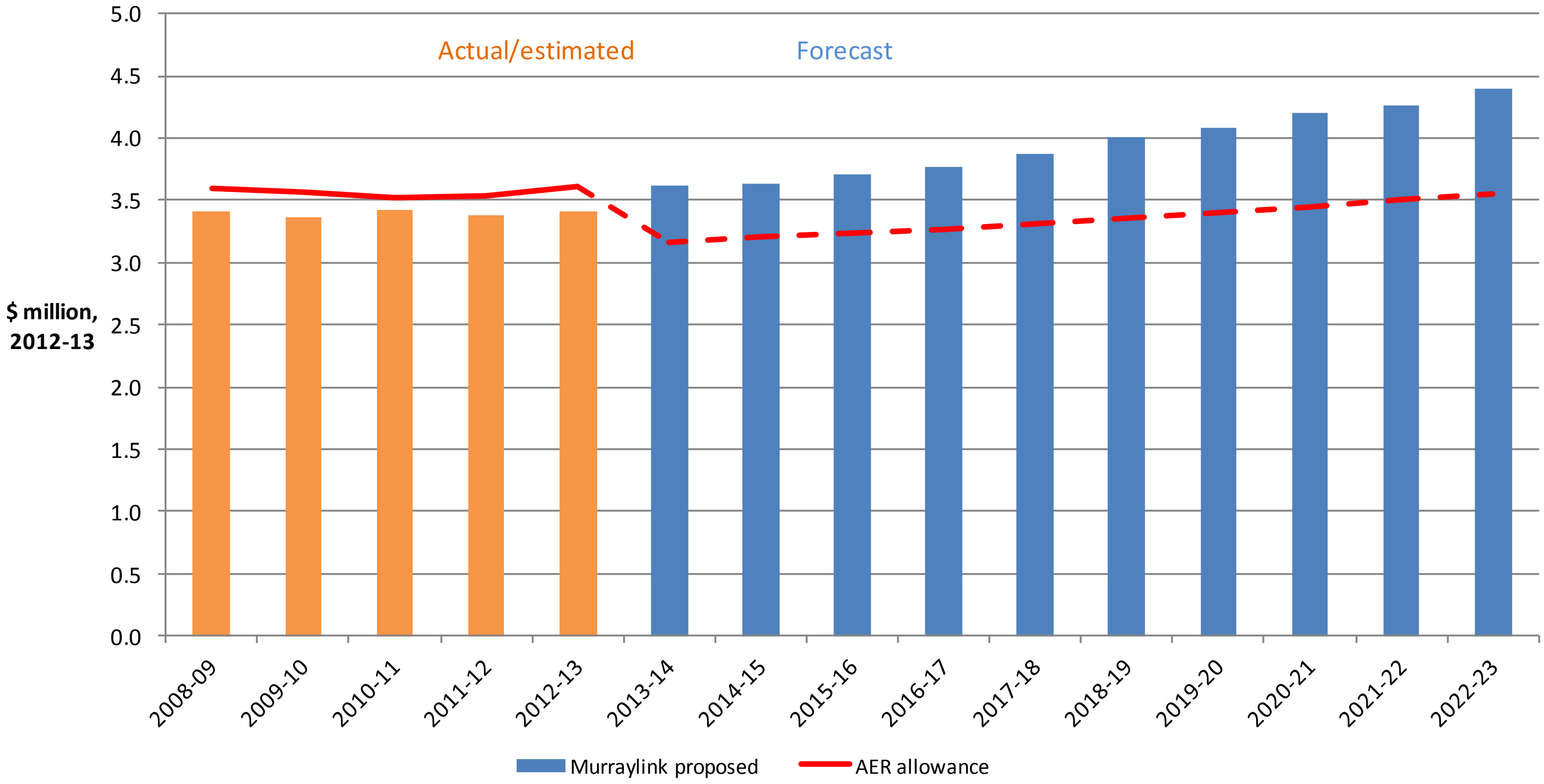
AER draft decision

- $7.3 million ($2012-13)
- decrease of 47 per cent

Reasons

- 3 projects either not substantiated or not a prescribed transmission service:
  - Control system end of life replacement
  - Black start capability
  - Contingent reduction of converter losses
- Update asset management framework
- Deliver capex efficiencies over the forecast

Opex allowance



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Opex allowance

Murraylink proposal

- $40.14 million ($2012-13)

AER draft decision

- $34.08 million ($2012-13)
- The AER will also apply an EBSS for the first time

Reasons

- Revealed costs of maintenance
- Overheads
- Cost escalation
- Opex efficiency factor, 2.5%

Cost of capital

Murraylink proposal

- 8.61 per cent

AER draft decision

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

Reasons

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

Cost of capital

WACC parameters	Murraylink's proposal	AER's draft decision
Nominal risk free rate (per cent)	4.17	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)	3.93	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)	9.37	8.23
Cost of debt (per cent)	8.10	6.37
Nominal vanilla WACC (per cent)	**8.61**	**7.11**

Contingent projects

Murraylink proposed a single contingent project:

- reinforce South Australia and Vic regional networks
- duplicate Murraylink interconnector
- valued at $816m to $918m

The AER did not accept the contingent project because:

- Limited explanation why Murraylink would reinforce SA regional network
- Contingent projects would not be the appropriate mechanism for recovering these revenues in Victoria
- Limited explanation why DC would be preferred to AC.
- Staged implementation of project

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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 for good performance / financial penalty for under performance
- AER accepted Murraylink's proposed service component values, which are unchanged from the current period.

Market impact component

- reward only scheme – no penalty for underperformance
- additional revenue increment of up to 2 per cent of MAR
- market impact component will apply to Murraylink for the first time during 2013-23 - target of 782.3 dispatch intervals.

Pricing methodology

- A pricing methodology is 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

- Approves Murraylink's proposed pricing methodology

Negotiated services

AER draft decision

- Approves Murraylink’s proposed negotiating framework

Reasons

- The AER is satisfied that Murraylink's proposed negotiating framework satisfies the NER requirements.
- It is also satisfied the proposed negotiating transmission service criteria (NTSC) specified in its draft decision give effect to and is consistent with the Negotiated Transmission Service Principles

Process – next steps

16 January 2013	Murraylink revised revenue proposal
19 February 2013	Submissions on revised proposal and draft decision
	Submissions to: murraylink.2013@aer.gov.au
30 April 2012	AER final decision
1 July 2013	Start of 2013-23 regulatory control period

Questions and comments