

Draft decision: ElectraNet transmission determination 2008-09 to 2012-13

Mr Steve Edwell
Chairman
11 December 2007

Complying proposal under chapter 6A

- Onus on TNSP to provide a proposal that meets the AER submission guidelines and NER requirements
- If satisfied that proposal is compliant, the AER must accept and publish the proposal
- ElectraNet's proposal was found to be compliant

Transmission determination

- A transmission determination under chapter 6A has **four** elements:
 - For prescribed services:
 - 1) revenue determination
 - 2) pricing methodology
 - For negotiated services:
 - 3) negotiating framework
 - 4) negotiated transmission service criteria (NTSC)

ElectraNet/South Australia context

- ElectraNet changed its capex assessment and governance processes:
 - Identified need for asset refurbishments
 - Undertook greater level of refurbishments
- ESCOSA's review of network reliability standards
- ESIPC and ETSA involvement in developing ElectraNet's capex proposal

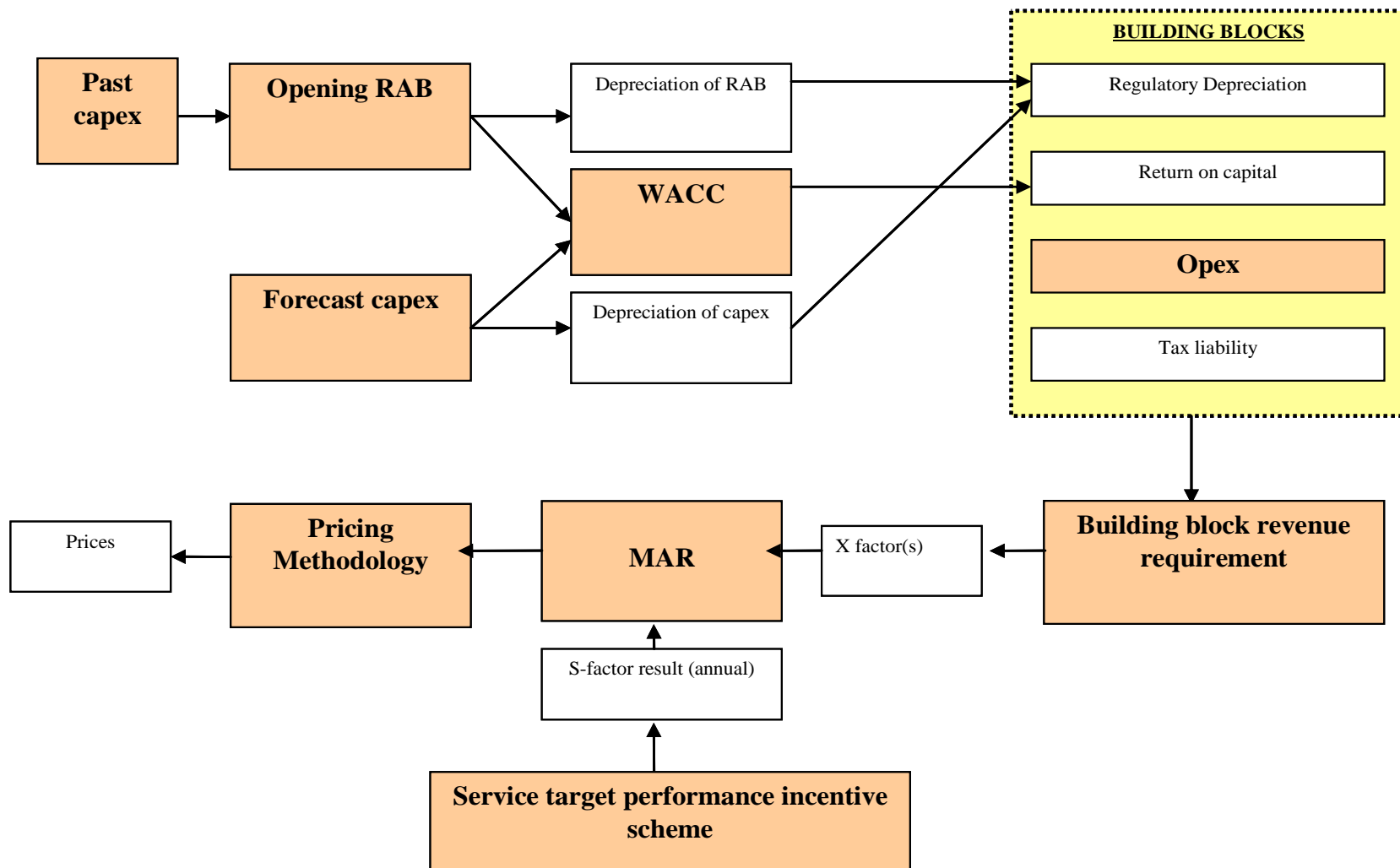
The AER consultants

- The AER engaged the following consultants to provide technical advice:
 - Sinclair Knight Merz
 - CHC Associates Pty Ltd
 - Econtech Pty Ltd

SKM review

- SKM review included:
 - Capital governance and asset management
 - Project identification, development and approval
 - Planning processes and criteria
 - Project management systems
 - Procurement systems
 - Detailed review of past & future capex sample projects
 - Sample selected in consultation with AER
 - Detailed review of project need
 - Detailed review of project scope and cost estimates
 - Opex
 - Methodology for forecasting opex
 - Historical levels and efficiency of nominated “base year”
 - Cost drivers
 - Asset management documentation practices

Draft decision – prescribed transmission services



Maximum allowed revenue

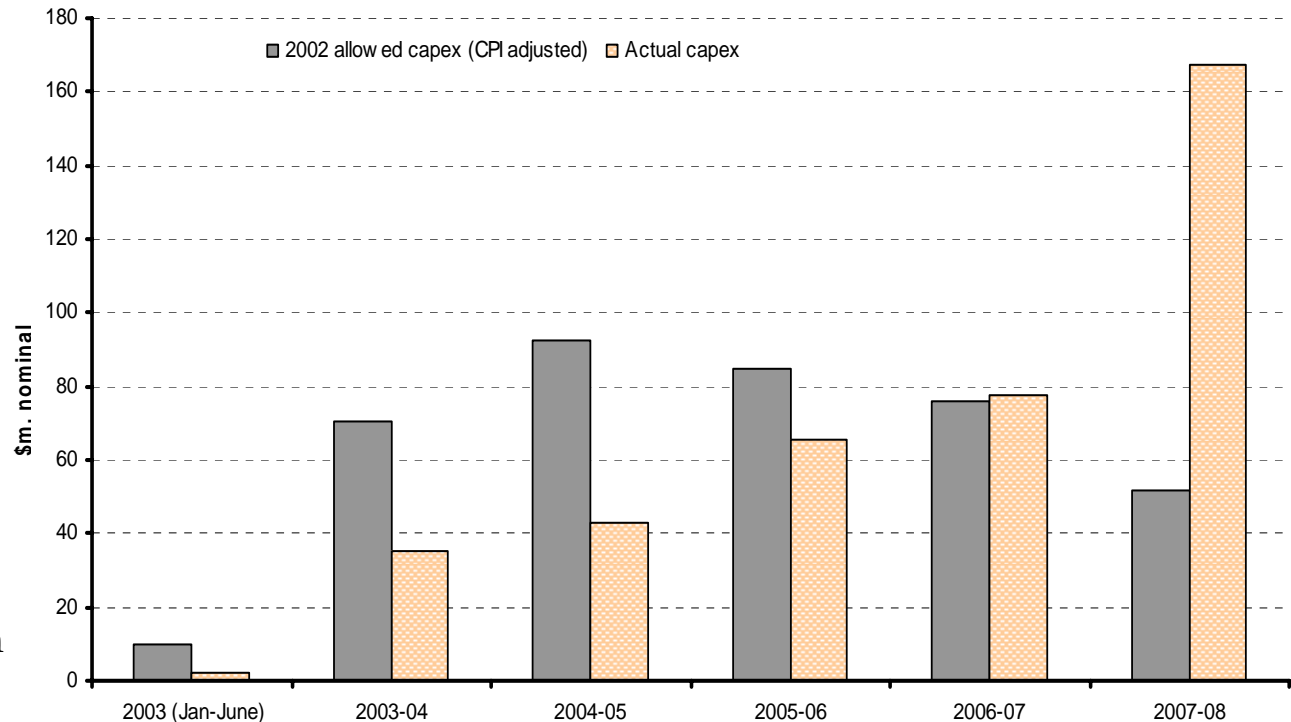
- **AER draft decision on MAR (\$m, nominal)**

	2008–09	2009–10	2010–11	2011–12	2012–13	Total
AER draft decision MAR (smoothed)	208.81	222.88	237.89	253.91	271.02	1194.52
ElectraNet’s proposal	208.52	225.14	243.09	262.46	283.39	1222.59
Difference	0.29	–2.26	–5.20	–8.55	–12.37	–28.07

Past capex

- ElectraNet proposed \$390 million of past capex (including \$27 million for interest during construction (IDC))
- Proposed assets under construction was \$44 million
- The AER approved ElectraNet's past capex including IDC and assets under construction
- The AER allowed further \$2 million for IDC associated with assets under construction
- The AER was satisfied that the change in capex profile was justified

Comparison of ElectraNet's 2002 allowance and its actual capex profile



Opening asset base

- AER draft decision on opening RAB (\$m, nominal)

	2003 (Jan to Jun)	2003–04	2004–05	2005–06	2006–07	2007–08
Opening RAB	823.75	832.83	883.96	958.36	1029.45	1082.89
Forecast capex (adjusted for actual CPI)	10.14	73.37	96.36	88.27	79.32	53.86
CPI adjustment on opening RAB	16.65	16.50	20.86	28.59	25.08	26.38
Straight-line depreciation (adjusted for actual CPI)	-17.71	-38.75	-42.81	-45.78	-50.95	-48.20
Closing RAB	832.83	883.96	958.36	1029.45	1082.89	1114.92
Add: prudent capex over 2002 decision						10.00
Add: return on difference						3.04
Add: prudent assets under construction						45.87
Add: easement landowner compensation costs						29.10
Add: readmitted optimised assets						17.44
Opening RAB at 1 July 2008						1220.36

RAB – easement adjustment and readmitted optimised assets

- Easement value adjustment:
 - ElectraNet proposed that the RAB be increased by \$82 million
 - Landowner compensation costs of \$29 million and easement acquisition transaction costs of \$53 million.
 - AER draft decision:
 - Accepted that ElectraNet’s easements should be revalued
 - Allowed only landowner compensation costs
 - Considered that transaction costs have already been paid for by users in the past
- Readmitted optimised assets:
 - ElectraNet proposed that \$21 million of previously optimised assets be readmitted
 - AER draft decision:
 - Based on CHC advice the AER accepted that these assets are required to provide prescribed transmission services and therefore should be readmitted

Forecast capex

- AER draft decision on ex ante capex allowance (\$m, 2007–08)

	2008–09	2009–10	2010–11	2011–12	2012–13	Total
ElectraNet's proposal	200.16	218.19	164.63	2129.52	65.68	778.08
AER's total adjustments	-77.34	-44.62	-37.77	-17.15	-11.86	-188.74
Transfer of opex projects to capex	3.31	3.34	3.39	3.44	3.48	16.96
AER's ex ante capex allowance	126.13	176.92	130.24	115.81	57.20	606.31

Forecast capex – adjustments

- Detailed project reviews:
 - Adelaide CBD project—line cost component transferred to contingent projects
 - Transformer ballistic proofing—transferred to contingent projects
 - Other projects—Weather stations project, Strategic easements project, Transposition errors
- Cost accumulation process:
 - Materials cost escalation—rejected ElectraNet’s methodology and adopted SKM’s recommendation
 - Land escalation—adopted weighted average using longer data period
 - Cost estimation risk factor—rejected proposed 5.2% risk factor and allowed 2.6%
 - Annual escalators—rejected the conversion of annual escalators to a uniform scale factor

Contingent projects

- ElectraNet proposal:
 - 17 contingent projects with total indicative cost of \$947 million
- AER draft decision:
 - 17 contingent projects with total indicative cost of \$805 million
 - Proposed projects removed from contingent projects
 - Northern transmission reinforcement project
 - Parafield Gardens West project
 - Ex ante capex projects transferred to contingent projects
 - Adelaide CBD line works
 - Transformer ballistic proofing

Cost of capital

- AER draft decision:
 - **Nominal vanilla WACC** **9.66%**
(ElectraNet proposal 8.79%)
 - Nominal pre-tax return on debt 7.93%
 - Nominal post-tax return on equity 12.25%
 - Inflation forecast 2.97%

Opex

- AER draft decision on total opex allowance (\$m, 2007–08)

	2008–09	2009–10	2010–11	2011–12	2012–13	Total
ElectraNet’s proposed total opex	59.58	61.53	64.38	67.78	70.50	323.77
AER’s total opex allowance	54.54	55.90	58.35	60.66	61.68	291.13
Difference	–5.04	–5.63	–6.03	–7.12	–8.82	–32.64

Service target performance incentive scheme (STPIS)

- ElectraNet has been subject to a performance incentive scheme since 2003.
- The parameters (or measures) applying to ElectraNet are set out in the AER's service target performance incentive scheme
- The AER reviewed the targets, caps, collars, weightings proposed by ElectraNet and minor aspects of parameter definitions
- AER draft decision:
 - Accepted the peak periods and weightings proposed by ElectraNet
 - Set performance targets, caps and collars for all parameters using data from five years
 - Added additional circuits to the list of critical circuits proposed by ElectraNet for the circuit availability sub-parameters

Pricing methodology

- Pricing methodology applies to prescribed transmission services
 - The pricing methodology is a set of principles for TNSPs to follow in determining the structure of prescribed transmission prices
- ElectraNet proposal:
 - ElectraNet submitted in accordance with the agreed interim requirements (transitional arrangements in lieu of the pricing methodology guidelines)
 - ElectraNet elected to have its proposed pricing methodology assessed against the final pricing methodology guidelines (as permitted under the agreed interim requirements)
- AER draft decision:
 - Proposed pricing methodology was rejected in the draft decision
 - ElectraNet must resubmit its revised pricing methodology by 14 December 2007
 - Submissions close on 31 January 2008 (30 business days)

Price path

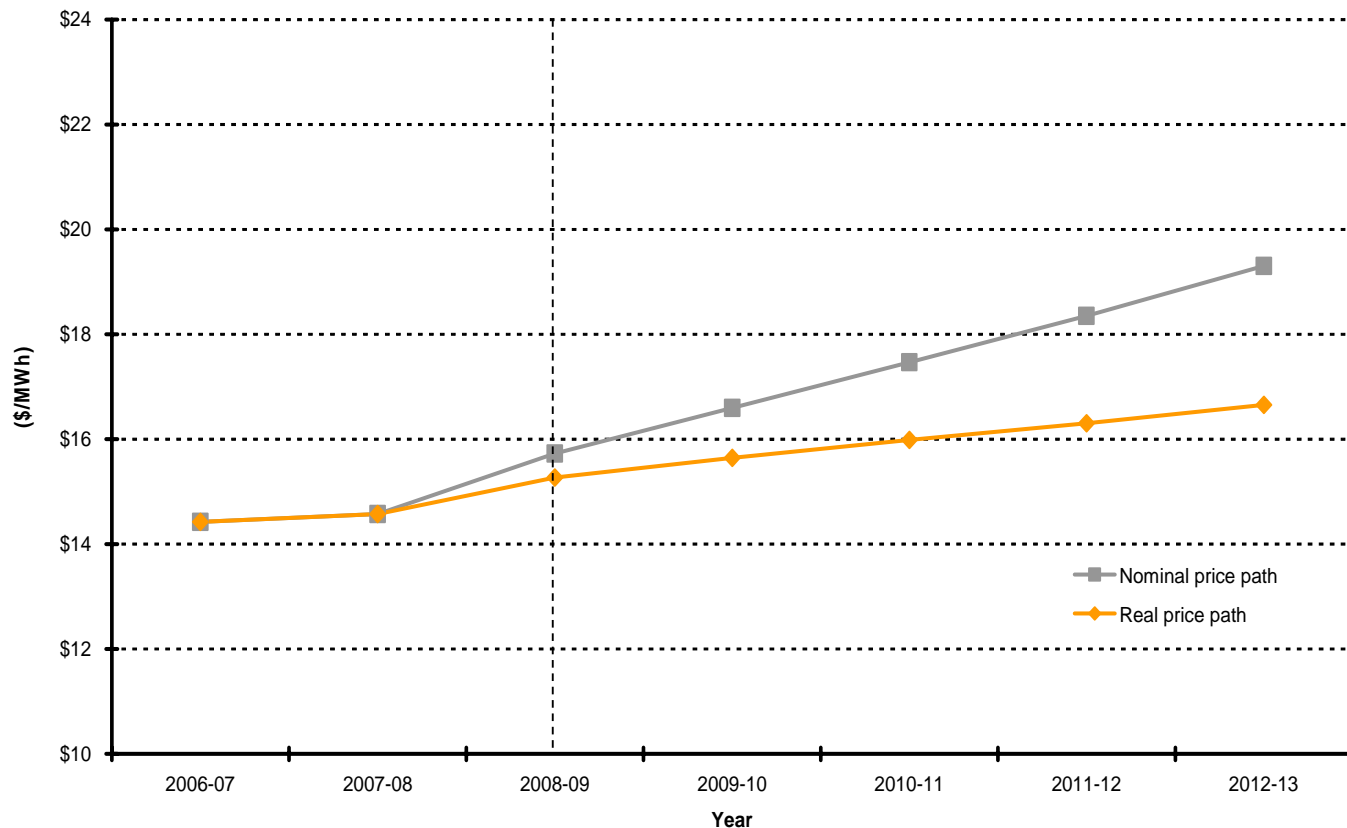
- Average transmission prices are estimated to increase by 5.9% per year in nominal terms or 2.9% in real terms

- Increase is primarily driven by:

- ETC connection standards related capex
- Replacement capex
- High input costs
- Increased opex

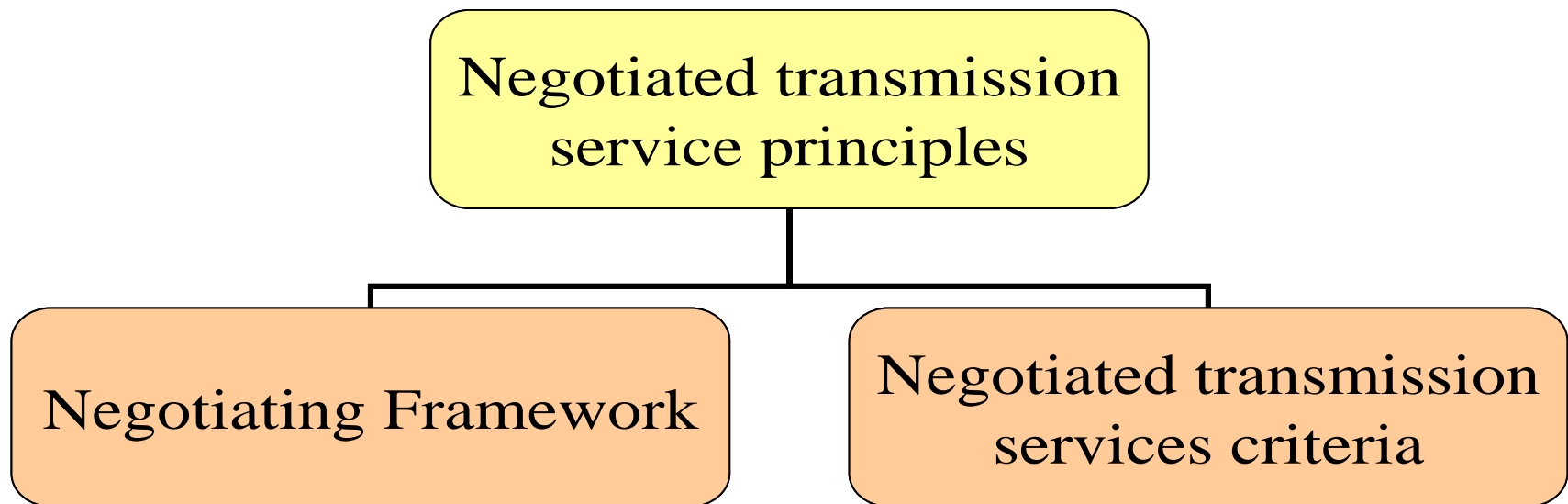
- The price increase is estimated to add about \$6.40 (0.6%) to average residential customer's annual bill

Price path from 2008–09 to 2012–13 (\$/MWh)



Negotiated services

- Three key elements to the negotiated transmission service regime – the negotiated transmission service principles, the negotiating framework and the NTSC
- Designed to be light-handed – minimum prescription, reliance on commercial negotiation between able counter parties
- Not subject to direct revenue control
- Commercial arbitration available if necessary



Process – next steps

- **14 December 2007** ElectraNet to provide revised pricing methodology
- **18 January 2008** ElectraNet may submit revised proposal or submission
- **31 January 2008** Submissions on revised pricing methodology close
- **18 February 2008** Submissions on draft decision and revised proposal close
- **April 2008** AER release final decision on transmission determination
- **1 July 2008** Commencement of the next regulatory control period