Revised Regulatory Proposal

Supporting Information: Demand Based Capex

Aurora response to the AER's Draft Distribution Determination

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Aurora Energy Pty Ltd
ABN 85 082 464 622
Level 2 / 21 Kirksway Place
Hobart TAS 7000
www.auroraenergy.com.au
Enquiries regarding this Document should be addressed to:
Network Regulatory Manager
Aurora Energy Pty Ltd
GPO Box 191
Hobart TAS 7001
e-mail: RRP2012@auroraenergy.com.au

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1. Introduction

Aurora provided the AER with its *Regulatory Proposal* on 31 May 2011 in accordance with the provisions of Chapter 6 of the *Rules*. Aurora also set out its answers to the Regulatory Information Notice (RIN) issued by the AER on 21 April 2011 in its response (*RIN Response*) of 31 May 2011.

The AER have reviewed Aurora's *Regulatory Proposal* and *RIN Response* and provided Aurora with the AER's *Draft Distribution Determination*, associated consultant's reports and AER models on 29 November 2011 in accordance with the provisions of Chapter 6 of the *Rules*.

Aurora provides its *Revised Regulatory Proposal* to the AER in response to the AER's *Draft Distribution Determination* in accordance with the provisions of Chapter 6 of the *Rules*. This document provides specific supporting information as an appended attachment to Aurora's *Revised Regulatory Proposal*

2. Background

In the RIN served on Aurora by the AER on 21 April 2011, the AER required that capital expenditure (capex) forecasts for services classified as Standard Control Services, being those services associated with work the shared network, be categorised as either:

- Capitalised overheads;
- System capex, for work associated directly with network assets; or
- Non-system capex for work indirectly associated with the distribution network;

with System capex to be sub-categorisation as

- Demand related, for work to extend the coverage or increase the capacity of the distribution network;
- Non-demand related, primarily associated with the replacement of existing assets at the end of their useful life, or works to improve distribution network reliability; and
- Regulatory Obligations or Requirements, for work to ensure that distribution network infrastructure is compliant with mandated standards (other than reliability).

Demand related capex was to be further categorised as either:

- Customer-initiated, if it were performed as the result of an identifiable new customer connection (or group of connections) or the modification of existing customer connection characteristics; or
- Reinforcements, for the work required to address the general increase in peak system load.

This paper addresses the capex associated with Reinforcements capex for the *Forthcoming Regulatory Control Period*, which is to commence on 1 July 2012 and end on 30 June 2017.

3. Regulatory Proposal

In its *Regulatory Proposal*, Aurora forecast total capex for Standard Control Services the *Forthcoming Regulatory Control Period* of $541.1 million, in June $2010, excluding escalations and overheads. Of this,

- $268.4 was forecast for Demand-related capex;

of which,

- $87.1 million was for Reinforcements capex.

Within the Reinforcements category, Aurora's forecast by Work Category is presented in the following total capex in Table 1.

Table 1. Aurora forecast capex for the Reinforcements RIN sub-category for the *Forthcoming Regulatory Control Period*

Work Category	Forecast Capex ($ million, June 2010, excluding escalations and overheads)
Embedded Generation Connection	0.463
HV Feeder Upgrade - Capacity	54.860
LV Feeder Upgrade - Capacity	1.128
SWER Line Replacement	1.216
Terminal Station Feeder Connections	4.063
Transformer Upgrades - Capacity	7.890
Zone Substation Upgrades - Capacity	6.727
Zone Substation Upgrades – HV Feeder Capacity	10.758
Total	**87.105**

4. Draft Distribution Determination

The AER engaged Nuttall Consulting to review Aurora's capex forecast for the *Forthcoming Regulatory Control Period* and the associated supporting documentation. Nuttall Consulting presented their findings in the *Report – Principle Technical Advisor, Aurora Energy Distribution Revenue Review* dated 11 November 2011 (the Nuttall Consulting Capex Report).

The AER rejected Aurora's whole proposed capex forecast, and substituted their own forecast.[1] In particular, the AER rejected aspects of Aurora's capex forecast for the Reinforcements RIN sub-category and substituted their own.

In arriving at their substitute forecast, the AER accepted the majority of recommendations made by Nuttall Consulting, but performed the modelling of the effects of the recommendations themselves. The AER presented only a summary of modelling approach in the *Draft Distribution Determination*, leaving the detail undocumented but in a version of the AER's model was provided to Aurora with the *Draft Distribution Determination*. The AER model AER spreadsheet *AER Capex Analysis – to Aurora*, of which the worksheet *timing review – exc overheads* is most relevant, has been referred to in this paper as it is often the only tangible link between Nuttall Consulting's recommendations and the AER's substituted capex forecasts.

The AER's substituted forecast by Aurora Work Category for the *Forthcoming Regulatory Control Period* is presented in Table 2.

Table 2. AER's Substituted Capex Forecast for the Reinforcements RIN sub-category for the *Forthcoming Regulatory Control Period*

Work Category	($ million, June 2010, excluding escalations and overheads)		Percentage Change
	AER's Substituted Forecast[2]	Aurora Forecast Capex	
Embedded Generation Connection	0.463	0.463	nil
HV Feeder Upgrade - Capacity	25.733	54.860	-53
LV Feeder Upgrade - Capacity	1.128	1.128	nil
SWER Line Replacement	0.407	1.216	-67
Terminal Station Feeder Connections	2.038	4.063	-50

[1] *Draft Distribution Determination*, page 105
[2] Source: AER spreadsheet *AER Capex Analysis – to Aurora*, worksheet *timing review – exc overheads*

Work Category	($ million, June 2010, excluding escalations and overheads)		Percentage Change
	AER's Substituted Forecast[2]	Aurora Forecast Capex	
Transformer Upgrades - Capacity	6.724	7.890	-15
Zone Substation Upgrades - Capacity	3.473	6.727	-48
Zone Substation Upgrades – HV Feeder Capacity	3.040	10.758	-68
Total	**43.005**	**87.105**	**-51**

5. Revised Regulatory Proposal

Aurora considers that there are several issues to be addressed as a result of the AER's substituted capex forecast for the Reinforcements RIN-subcategory for the *Forthcoming Regulatory Control Period*. This section provides the major issues in Aurora's *Revised Regulatory Proposal*. For reference, a more complete review of the AER's findings regarding demand based capex is contained within the document *Revised Regulatory Proposal, Supporting Information: Demand Based Capex – Detailed Review of the AER's Assessment, Aurora Response to the AER's Draft Distribution Determination, January 2012.*

5.1. Substitute Capex Estimation Methodology

In assessing Aurora's capex forecast for the Reinforcements RIN category, the AER did not consider every project. Rather, based upon a sample of projects, a set of factor were calculated by which to reduce Aurora's forecasts, which values became the AER's substitute capex forecast for this category.

Aurora considers that this approach is inappropriate for the following reasons:

- the AER used a high-level assessment approach, which it has previously stated to be ineffective;
- the AER has previously stated that the *Rules* require it to perform a line by line assessment of a capex forecast to ascertain whether it is efficient, but did not perform a line by line assessment;
- the AER has previously stated that the *Rules* require it to perform a line by line assessment of a capex forecast to ascertain a reasonable substitute, but did not perform a line by line assessment;
- the AER has not demonstrated that the substituted forecast meets the capex criteria;
- the AER has inappropriately substituted capex in the forecast.

These issues are discussed in more detail in section 8 of this document.

Aurora does not accept the AER's substituted capex forecasts for the Reinforcements RIN subcategory that have been derived using this methodology.

5.2. Incorrect Project Assessments

Aurora considers that the AER has made errors in the assessment of the following projects:

- the St Leonards Terminal Substation feeder construction project;
- the Geilston Bay Conductor Augmentation Project;
- the Sandford Conductor Augmentation Project;

These are discussed more in the following sections.

5.2.1. St Leonards Terminal Substation Feeder Construction Project;

The Transend-owned St Leonards Terminal Substation, needed to address supply constraints in the greater Launceston area, is currently under construction, with commissioning expected in May 2012. Aurora plans the staged construction of 10 feeders from this Terminal Substation to permit load management in Launceston. Aurora forecast expenditure for the *Forthcoming Regulatory Control Period* for feeder development from this injection point.

Nuttall Consulting did not perform a detailed review of capex forecast for this project, neither did the AER. Rather, the AER applied the uniform factor of 0.46 to all components of expenditure associated with Rosny Zone Substation, considering that 54 per cent of the work was to address issues other than demand.[3]

The St Leonards Terminal Substation, associated additional distribution infrastructure, and reconfiguration of existing distribution infrastructure to accommodate such were the subject of a joint Transend-Aurora Regulatory Investment Test and consultation completed in April 2010.

Aurora does not accept the AER's assessment that 46 per cent of the forecast associated with this project is demand related.

Aurora does not accept the AER's substituted capex forecast for the St Leonards Terminal Substation project.

Aurora will address this in the attached paper *Revised Regulatory Proposal Supporting Information: St Leonards Substation (Section 9.4.6, Capacity Management Plan 2011), Aurora Response to the AER's Draft Distribution Determination*, January 2012.

5.2.2. Geilston Bay Conductor Augmentation Project;

Geilston Bay Zone Substation supplies the Geilston Bay, Risdon Vale, Otago, Risdon, Lindisfarne and Rose Bay areas on the Eastern Shore of Hobart. The load on Geilston Bay is currently in excess of firm capacity. In addition, one of the feeders, number 26167, is presently loaded beyond its planning rating, with the loading forecast to increase every year into the future.

Given the age of the transformers in the Zone Substation, Aurecon recommended that Aurora look to undertaking replacement in 2013/14, with replacement contingent upon transformer condition, at an expected cost of $4 million.[4] Aurecon had also suggested the construction of a new feeder from Geilston Bay Zone Substation to take some of the load on the existing, overloaded feeder 26167.[5]

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[3] AER spreadsheet *AER Capex Analysis – to Aurora*, worksheet *timing review – exc overheads*
[4] Aurecon Report, page 21
[5] Aurecon Report, page 48

Aurora recognised that the unloading of feeder 16167 in conjunction with the future load transfer to the new Rosny Zone Substation may extend the life of the existing transformers by allowing them to operate at under their firm capacity. That is, the construction of the new feeder can potentially defer the need to replace two Zone Substation transformers until beyond the end of the *Forthcoming Regulatory Control Period*.

In its *Regulatory Proposal*, Aurora forecast capex of approximately $0.25 million for the construction of the new feeder. The AER's Principle Technical Advisor, Nuttall Consulting, considered that, after taking into account the effect of the AER's demand forecasts, only 33 per cent of the project cost was related to addressing demand-related issues. The AER, in the *Draft Distribution Determination*, used this value in their substituted capex forecast.

Aurora considers that the AER and Nuttall Consulting have inappopriately substituted the forecast capex for the network component of the project.

Aurora does not accept the AER's substituted capex forecasts for the Geilston Bay Conductor Augmentation project.

This project is addressed in the attached paper *Revised Regulatory Proposal, Supporting Information: Geilston Bay Conductor Augmentation Project (Section 10.4.1, Capacity Management Plan, 2011), Aurora Response to the AER's Draft Distribution Determination*, January 2012.

5.2.3. Sandford Conductor Augmentation Project

This project is to manage feeders from the Rokeby Terminal Substation serving the Sandford Area exceeding their planning ratings, and to address voltage drops in the area.

Nuttall Consulting conducted a detailed review of this project, and agreed that the problem existed as described by Aurora, but was unconvinced that Aurora had chosen the "most appropriate" solution.[6]

Nuttall Consulting considered that 0 per cent of forecast capex for this project was demand-related because:

- it was inconsistent with the Futura Report; and
- it had been accounted for in the non-network project reviewed elsewhere.[7]

Nuttall Consulting considered that, when the AER reduced demand forecast is taken into account, the demand-related fraction increases to 10 per cent.[8]

The AER, in making its revised forecast of capex for this category, used Nuttall Consulting's value for the demand-related capex portion.[9]

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[6] Nuttall Consulting Capex Report, page 171
[7] Nuttall Consulting Capex Report, page 50
[8] Nuttall Consulting Capex Report, page 62
[9] AER spreadsheet *AER Capex Analysis – to Aurora*, worksheet *timing review – exc overheads*

Aurora considers that Nuttall Consulting have misunderstood the interaction between the non-network solution, which is to primarily intended to defer the need for the construction of a zone substation at Sandford, and this project, which is to enable the management of loads on the existing terminal substations supplying the area.

The view formed by Nuttall Consulting and acquired by the AER is incorrect. The effect of the formation of this view is further compounded by the AER's decision to reject funding for the acquisition of mobile generators that were to be the mainstay of the non-network solution for the area.

Aurora does not accept the AER's substituted capex forecast for the Sandford conductor augmentation project.

Aurora will address this in the attached paper *Revised Regulatory Proposal, Supporting Information: Conductor Augmentation – Sandford (Section 10.4.1, Capacity Management Plan 2011), Aurora Response to the AER's Draft Distribution Determination*, January 2012.

6. References

- *Revised Regulatory Proposal Supporting Information: St Leonards Substation (Section 9.4.6, Capacity Management Plan 2011), Aurora Response to the AER's Draft Distribution Determination,* January 2012.
- *Revised Regulatory Proposal, Supporting Information: Geilston Bay Conductor Augmentation Project (Section 10.4.1, Capacity Management Plan, 2011), Aurora Response to the AER's Draft Distribution Determination,* January 2012.
- *Revised Regulatory Proposal, Supporting Information: Conductor Augmentation – Sandford (Section 10.4.1, Capacity Management Plan 2011), Aurora Response to the AER's Draft Distribution Determination,* January 2012.
- *Revised Regulatory Proposal, Supporting Information: Demand Based Capex – Detailed Review of the AER's Assessment, Aurora Response to the AER's Draft Distribution Determination, January 2012*

7. Confidentiality

Aurora does not consider any information contained within this document to be confidential.

8. Appendix: AER's Reinforcements Capex Assessment Methodology

8.1. Introduction

In assessing Aurora's capex forecast for the Reinforcements RIN category, the AER did not consider every project. Rather, based upon a sample of projects, a set of factor were calculated by which to reduce Aurora's forecasts, which values became the AER's substitute capex forecast for this category. Aurora considers that this approach is not appropriate.

In the following sections are summarised the assessment approaches used by the AER's Principle Technical Advisor, Nuttall Consulting, and the AER in arriving at a substitute capex forecast for the Reinforcements RIN category, and the concerns that Aurora has about the process used.

8.2. Nuttall Consulting's Approach

The AER engaged Nuttall Consulting to review parts of Aurora's forecast capex. To the best of Aurora's knowledge, the Terms of Reference for the engagement have not been published. Accordingly, Aurora considers that any issues arising as a result of the review of Aurora's forecast capex lie with the AER, unless it is evident that Nuttall Consulting has erred in its interpretation of information.

With regards to forecast capex in the Reinforcements RIN category, in the first instance Nuttall Consulting benchmarked Aurora's expenditure in this category against the Victorian distributors, noting that Aurora spent relatively more capex for demand purposes with a lower demand growth rate.[10]

Nuttall Consulting also observed:

> *...we consider that the analysis supports a view that Aurora may not be managing assets in a prudent and efficient fashion*[11]

and used this observation as a justification for a detailed review of Aurora's capex. Following a general review of Aurora's overarching Reinforcements category documentation, Nuttall Consulting identified specific projects for detailed analysis, and further projects for general review.[12]

The general approach for the reviews was to:

- compare the specific project documentation against the overarching project documentation;
- estimate what portion of the project is to address demand issues;[13]

[10] Nuttall Consulting Capex Report, page 37
[11] Nuttall Consulting Capex Report, page 37
[12] Nuttall Consulting Capex Report, page 38
[13] Nuttall Consulting Capex Report, section 5.6

- review the demand-based portion in light of the AER's demand forecast, and revise the estimate of the portion of the project is to address demand issues, if required.[14]

Nuttall Consulting used these estimates in developing a substitute forecast for the Reinforcements capex category. The spreadsheet *For AER – reinforcement calcs v2.xls*, provided to Aurora with the *Draft Distribution Determination* seems to perform this function.

8.3. AER's Methodology

The AER provided to Aurora with the *Draft Distribution Determination* a spreadsheet, *AER Capex Analysis – to Aurora*, that was used in the calculation of a substituted capex forecast for the Reinforcements RIN category. Aurora notes, however, that this spreadsheet links to at least one other spreadsheet that was not provided to Aurora. Accordingly, Aurora is not able to ascertain the full extent of modelling performed by the AER to arrive at its preferred value.

The approach used by the AER to arrive at a substituted forecast appears to be as follows:

- Aurora's Reinforcements program was arranged such that projects for similar purposes were grouped together;
- an aggregate weighting of demand-related forecast expenditure was calculated for each group. That is:
    - the projects subject to detailed review within a given group (the "reviewed projects") were isolated;
    - the total value of the reviewed projects over the *Forthcoming Regulatory Control Period* was calculated;
    - the fraction that each of the reviewed projects contributed to the total value of the reviewed projects (the "weight" of the projects) was calculated;
    - the weight of each project was multiplied by the AER's estimate of demand-related expenditure for that project (which nearly always aligned with the Nuttall Consulting assessment of the same value) to arrive at a "weighted allowance";
    - the weighted allowances for all of the isolated projects were summed to give the "aggregate weighting" for the group;
- the aggregate weighting for a given group was applied to every project within a that group;
- the resulting demand-related capex portions of projects within the Reinforcements RIN category were summed to arrive at a substitute forecast.

[14] Nuttall Consulting Capex Report, section 5.7

8.3.1. A Worked Example of the AER's Revealed Methodology for Calculating the Substituted Capex Allowance

This example is replicated from the AER spreadsheet *AER Capex Analysis – to Aurora*, worksheet *timing review – exc overheads*.

Consider the AER's group "Zone Substations – Not Involving Deferral". This group contains five projects (Richmond Zone Substation, Rosny Zone Substation, Wesley Vale Terminal Substation, St Leonards Terminal Substation, and Rosebery Terminal Substation), of which the first three were subject to detailed review by Nuttall Consulting.

The results of the steps AER's approach to calculating the "aggregate weighting" is demonstrated in Table 3, with the aggregate weighting for this group of projects is 46 per cent (number in bold, lower right cell of the table). Three of the five projects were isolated for the purposes of this calculation because they were the ones subject to detailed review by Nuttall Consulting. Please note that, in the actual calculation the values are not rounded as shown in Table 3.

The application of this aggregate weighting to the five projects is demonstrated in Table 4. Please note that, due to the number of displayed decimal places, the products of the weighted allowance and the Aurora forecast capex do not reconcile exactly with the numbers shown in the Substituted forecast.

Note also that, despite the three projects subject to individual review receiving an explicit weighting (for example, Rosny Zone Substation was weighted 100 per cent on review) the actual substituted capex allowance is only 46 per cent of Aurora's forecast capex for the project. This does not have a material effect when the substituted capex values for the three isolated projects are considered in aggregate.

Table 3. Example of AER's Calculation of the Aggregate Weighting for the "Zone substations – not involving deferral" Group of Projects

Project	Aurora Forecast ($2010, exc. overheads)	Project Weight	Demand-related Fraction	Weighted Allowance
Richmond	4,869,346	0.3928	33%	13%
Rosny	2,408,906	0.1943	100%	19%
Wesley Vale	5,116,698	0.4128	33%	14%
Total	12,394,950	1.000	-	**46%**

Table 4. Example of AER's Application of the Calculated Aggregate Weighting to the "Zone substations - not involving deferral" Group of Projects

Project	Aurora Forecast ($2010, exc. overheads)	Aggregate Weighting	Substituted Forecast ($2010, exc. overheads)
Richmond	4,869,346	46%	2,254,007
Rosny	2,408,906	46%	1,115,076
Wesley Vale	5,116,698	46%	2,368,505
St Leonards	1,267,425	46%	586,687
Rosebery	4,381,537	46%	2,028,201
Total	**18,043,912**		**8,352,476**

8.4. Aurora's Concerns

Aurora has several concerns about the approach used by the AER to assess Aurora's capex forecast. These are presented in the following sections.

8.4.1. Effectiveness of a "Top-down" Assessment

In September 2011 the AER proposed a suite of changes to be made to the *Rules* to address a series of issues that the AER claimed were restricting its ability to properly fulfil its role as an economic regulator. In the Rule Change Proposal, the AER observes that,

> *...the current restrictions that the substitute can only be amended after a line by line assessment of the proposal create a very high evidentiary burden in an environment where there are clear information asymmetries. For example, in the recent AER decision for the Victorian DNSPs, the review of the augmentation (reinforcement) capex forecast was informed by a detailed examination of around 30 per cent of each DNSP's proposed expenditure. The service providers then submitted additional information on the projects reviewed by the AER's consultant.*
>
> *The projects amenable to examination in detail are dominated by higher value projects, with proportionately greater numbers of supporting documents. This level of detailed assessment was not an outcome envisaged by the AEMC, rather it considered that the AER would be able to readily test the information provided at a high level.*
>
> *However, given restrictions in the current rules, such high level assessments cannot be applied effectively. In the case of the Victorian DNSPs, the AER was only able to apply an adjustment to the 30 per cent of proposed augmentation capex that had been examined in detail. Since it is not realistic for the AER to examine each individual cost incurred by an NSP over a five year period, it is inevitable that a proportion of costs escape regulatory scrutiny.*

The "current rules" to which the AER refers is the current chapter 6 of the *Rules*, under which the AER assessed Aurora's expenditure forecasts, using high level assessments that the AER has noted "cannot be applied effectively".

Given the AER's own statement on the unsatisfactory nature of a high-level, sampling approach in assessing expenditure forecasts, Aurora considers that the AER's assessment that Aurora's capex forecast was not satisfactory is invalid.

8.4.2. Obligation to Perform "Bottom-up" Reviews

In September 2011 the AER proposed a suite of changes to be made to the *Rules* to address a series of issues that the AER claimed were restricting its ability to properly fulfil its role as an economic regulator. In the Rule Change Proposal, the AER noted, in relation to making a substituted expenditure forecast,

> *...that the AER's response must be determined on the basis of the regulatory proposal also locks the regulator into forming a substitute in the same manner as determined by the DNSP in its proposals.*
>
> *As most proposals are based on a large amount of engineering detail and a 'bottom up' calculation of the required expenditure, the AER must conduct a line by line analysis in order to reduce the forecast to fall back within the 'reasonable' range.*[15]

The AER expanded their thoughts in subsequent sections:

> *... any substitute forecast determined by the AER must be based on the original proposal. In an environment where forecasts proposed by DNSPs are routinely constructed using a bottom-up, project-by-project approach, the AER has found it necessary to also use a line by line 'bottom-up' approach to assessing forecasts.,*

and,

> *The second restriction that the substitute must be formed on the basis of the DNSP's proposal, locks the regulator into forming a substitute in the same manner as determined by the DNSP in their proposal. As most proposals are based on a large amount of engineering detail and a 'bottom up' calculation of the required expenditure, the AER must conduct a line by line analysis in order to reduce the forecast to fall back within the 'reasonable' range.*

Aurora notes that the AER did not perform a line-by-line assessment of Aurora's capex forecast.[16] Rather, the AER performed an assessment on a sample of projects contained within the forecast, and then used values ascertained from the sample to adjust forecasts of the remaining, un-sampled projects. Based upon the AER's interpretation of the *Rules*, Aurora concludes that the approach used by the AER to assess Aurora's capex forecast is invalid. It follows that the substituted forecast is, itself, invalid.

[15] Rule Change Proposal, page 13
[16] *Draft Distribution Determination*, page 138

8.4.3. "Reasonably Reflect" Requirement

In September 2011 the AER proposed a suite of changes to be made to the *Rules* to address a series of issues that the AER claimed were restricting its ability to properly fulfil its role as an economic regulator. In the Rule Change Proposal, the AER observed that,

> *The rules currently require the AER to accept proposals from NSPs if it is satisfied they 'reasonably reflect' efficient, prudent and realistic expenditure. ... if the AER is not satisfied a forecast proposed by a DNSP reasonably reflects the required expenditure, the AER may only amend it to the minimum extent necessary for it to be approved under the rules.*[17]

The AER observes later in the same document that,

> *The restriction in chapter 6 that the AER must only amend the proposal to the extent necessary to make it capable of being approved under the rules, limits the flexibility to weigh up all available information, evidence and data to determine a forecast. If a proposal is submitted outside of the top of the range that the AER is satisfied 'reasonably reflects' the required expenditure, the AER has found it necessary to conduct a line by line assessment in order to bring it back into the very top of the range.*[18]

Given that the AER states that a line-by-line assessment of expenditure is required to adjust an "unacceptable" expenditure forecast such that it becomes "acceptable", and the AER did not conduct a line by line assessment of Aurora's expenditure, Aurora considers that the AER's substitute expenditure forecast is invalid.

8.4.4. Justification of Substitute Forecast

In September 2011 the AER proposed a suite of changes to be made to the *Rules* to address a series of issues that the AER claimed were restricting its ability to properly fulfil its role as an economic regulator. In the Rule Change Proposal, the AER summarised the requirements for making a substituted expenditure forecast:

> *The rules currently require the AER to accept proposals from NSPs if it is satisfied they 'reasonably reflect' efficient, prudent and realistic expenditure. ... if the AER is not satisfied a forecast proposed by a DNSP reasonably reflects the required expenditure, the AER may only amend it to the minimum extent necessary for it to be approved under the rules.*[19]

In ascertaining whether the capex forecast "reasonably reflects" efficient, prudent and realistic expenditure, the AER should, under the *Rules*, consider whether the forecast meets the capex criteria[20], having had regard for the capex factors[21]. It follows that a capex forecast substituted by the AER should also should meet the capex criteria, having had regard for the capex factors.[22]

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[17] Rule Change Proposal, page 13
[18] Rule Change Proposal, page 28
[19] Rule Change Proposal, page 13
[20] *Rules*, clause 6.5.7(c)
[21] *Rules*, clause 6.5.7(e)
[22] *Rules*, clause 6.12.1(3)(i)

In the *Draft Distribution Determination*, the AER stated that,

> *In deciding whether Aurora's proposed total forecast capex reasonably reflects the capex criteria, the AER must have regard to the capex factors. Although the AER has considered each capex factor when assessing Aurora's proposed total forecast capex, not all factors are relevant for assessing each capex component. Therefore, the AER has made its determination by examining:*
>
> - *the amount of forecast capex that it considers would reflect the efficient costs of achieving the capex objectives*
> - *whether Aurora's proposed forecast capex reasonably reflects the AER's forecast of efficient capex (in total)*
> - *those item(s) of Aurora's proposed forecast capex that do not appear to reflect the AER's forecast.*[23]

In light of this, Aurora considers that the AER has not demonstrated that its substituted capex forecast for the Reinforcements RIN category meets the capex criteria, having had regard for the capex factors.

Further, in arriving at its substitute forecast, the AER has reduced the capex forecasts for projects in the category by a series of factors, with the factors being based on the proportion of project capex assessed to be demand-related (see section 8.3 for more details). Aurora contends that this approach does not "reflect the efficient costs of achieving the capex objectives". Rather it reflects the portion of costs in the Reinforcements RIN category that should have been reclassified to another RIN category.

As a result, Aurora considers that the AER's substitute capex forecast for the Reinforcements RIN category is incorrect.

8.4.5. Appropriateness of Substitute Forecast

The AER, in making the substitute forecast for the Reinforcements RIN category applied reduced the capex forecasts for projects in the category by a series of factors, with the factors being based on the proportion of project capex assessed to be demand-related (see section 8.3 for more details). The AER justifies this approach by stating,

> *... only small components of most projects the AER has reviewed have a direct correlation with the need to meet or manage expected demand. The AER considers the remaining capex is beyond what is required for Aurora to achieve the capex objectives because it is driven by operational efficiencies and/or improvements in reliability.*[24]

The capex objectives are given in clause 6.5.7(a):

> *(a) A building block proposal must include the total forecast capital expenditure for the relevant regulatory control period which the Distribution Network Service Provider considers is required in order to achieve each of the following (the capital expenditure objectives):*

[23] *Draft Distribution Determination*, page 111
[24] *Draft Distribution Determination*, page 137

> *(1) meet or manage the expected demand for standard control services over that period;*
>
> *(2) comply with all applicable regulatory obligations or requirements associated with the provision of standard control services;*
>
> *(3) maintain the quality, reliability and security of supply of standard control services;*
>
> *(4) maintain the reliability, safety and security of the distribution system through the supply of standard control services.*

Aurora notes that "improvements in reliability" are part of the capex objective (2) in areas that experience reliability outside the jurisdictional standards.

Aurora also notes the "operational efficiencies" mentioned by the AER also contribute capex objectives (3) and (4). Aurora addressed this in section 4.5.5.12 of *RIN Response Part B Capital expenditure*, which was provided to the AER with the RIN template and *Regulatory Proposal*.

The AER has not considered these issues in making its substitute forecast, rendering that substitute forecast incorrect.

9. Appendix: Glossary of Terms Used in this Document

AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
Aurecon Report	*System Strategic Planning Capacity Report – Hobart East, 2010*, produced by Aurecon for Aurora, which was attachment AE046 to Aurora's Regulatory Proposal
Capacity Management Plan	*Capacity Management Plan 2011, (System Development Thread)*, attachment AE033 to Aurora's Regulatory Proposal
Capex	Capital expenditure
DNSP	Distribution Network Service Provider
ESI Act	Electricity Supply Industry Act 1995
Forthcoming Regulatory Control Period	The period commencing on 1 July 2012 and ending on 30 June 2017
Futura Report	*Identification of Non-network Initiatives for the 2012-17 EDPR* produced for Aurora by Futura Consulting in July 2010, which was attachment AE055 to Aurora's *Regulatory Proposal*
HV	High Voltage, as defined in the ESI Act
kV	KiloVolts
kVA	KiloVolt-Amps
LV	Low Voltage, as defined in the ESI Act
MVA	MegaVolt-Amps
NSP	Network Service Provider
Nuttall Consulting Capex Report	*Report – Principle Technical Advisor, Aurora Energy Distribution Revenue Review, prepared by Nuttall Consulting*, dated 11 November 2011
RIN	Regulatory Information Notice
Rule Change Proposal	*Rule Change Proposal Economic Regulation of Transmission and Distribution Network Service Providers, AER's Proposed Changes to the National Electricity Rules*, published by the AER in September 2011
Rules	National Electricity Rules
SWER	Single Wire Earth Return