

30 August 2021



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Dear Mr Roberts,

Thank you for the opportunity to provide comments on the *AER standardised model for Standard Control Services capital expenditure* issues paper. We welcome the development of a standard control services (SCS) capex model as we can see the benefits of having a standardised process for mapping capex proposals to post-tax revenue model (PTRM) asset categories. This will reduce resources required for data review and quality assurance from both AER and NSP's perspective.

We also agree with the AER that a standardised capex model will increase regulatory certainty for stakeholders through a consistent treatment of capex data across determinations. We note that the standardised model does not replace the need for us to maintain our own internal capex build-up model, and we will continue therefore to populate and maintain two models.

We appreciate that a standardised capex model by its nature cannot incorporate the unique characteristics and forecasting approaches of each regulated business. However, we hope that through standardisation of input and output formats and calculation methodology, the model would be reasonably fit-for-purpose and supported by stakeholders.

Please refer to the Attachment for our comments on the draft model.

We look forward to working with you and stakeholders to work through issues raised and throughout the model development process. If you have any questions regarding this submission please contact Fiona McAnally on [REDACTED]

Yours sincerely

Alex McPherson
Head of Regulation

Attachment - Comments on Standardised model for SCS capex

1. Forecast period

The roll-forward model (RFM) feeds the opening RAB into the PTRM. Given the timing of initial regulatory submissions by businesses, capex forecasts (in lieu of actuals) for the last two years of the current regulatory period would initially be entered into the RFM model. To facilitate the consistency and quality assurance of inputs for forecast capex into the RFM and PTRM models, it would be useful for the standardised SCS capex model to also include forecast capex inputs for the last two years of the current regulatory period, in addition to the five-year forecast for the upcoming regulatory period.

2. Base year for escalation

We note that the model allows users to select a base year for unescalated direct costs inputs to be escalated to the regulatory base year.

However, currently in the model, the base year for escalation of unescalated direct costs does not necessarily match the base year for real price escalation of internal labour. The calculation of the internal labour index in the model effectively assumes a base year which is three years prior to the first year of the forecast regulatory control period. This base year may not be consistent with the base year for inputs of unescalated direct costs on which the internal labour index is to be applied. For consistency of escalation calculations, the model should have a consistent base year from which escalation is to be performed.

3. Real price escalation

The model allows for real cost escalation of labour costs but does not include the escalation of contract services or materials costs. The AER references this approach to their draft decision for Powercor distribution determination 2021-26.

We disagree with this approach in the preliminary model. We believe that businesses should be given the flexibility through this model to propose their real cost escalations for all costs during the regulatory reset process. We propose that the real price escalation section of the model be extended to also include inputs for real cost escalation of contract services and materials costs.

4. Project inputs and mapping

The model assumes 1:1 mapping of projects to AER categories and RIN categories. For many of Ausgrid's projects, projects are mapped against multiple regulatory drivers. Therefore, to provide sensible outputs from the model, we suggest a mapping approach similar to the mapping of projects against PTRM asset classes in the model. This will enable businesses to input the appropriate percentages of a project against the relevant AER categories and RIN categories.

5. Capital contributions as % of direct costs

The model requires that the direct unescalated costs that are entered in Section 12 of the model are inclusive of gifted assets. It then requires percentage inputs in Section 15 to indicate the proportion of direct costs that are capital contributions, either as cash or assets.

It would be easier and more transparent if businesses are able to input their direct costs excluding gifted assets directly into the model separately from a direct dollar input of gifted assets. Providing percentage inputs in Section 15 requires additional data manipulation of raw data sources by businesses that reduces transparency.

6. Input for capitalised overheads

The model allows the user to enter inputs for unescalated capitalised overheads – network and corporate – in the Input | Overheads worksheet. While these are clearly input data, the model treats these inputs as being entered directly in dollars of the “base year for outputs” rather than in dollars of the “base year for inputs”, as set out in the Inputs | Escalation worksheet. There is therefore inconsistency in the model in the base year for input data for capitalised overhead inputs and the model inputs for unescalated direct costs. This could be addressed for consistency and clarity.

As an alternative to directly entering forecasts for capitalised overheads, the model prescribes a methodology for forecasting overheads by taking capitalised overheads for the current period and adjusting them up or down in proportion to forecast direct costs. The AER has determined a proportionality factor of 25 per cent, referring to their standard approach for adjusting capitalised overheads in recent decisions and has embedded this factor into the calculations.

Similar to our comment above regarding allowing businesses to propose real cost escalations, it is our view that the AER should allow businesses to propose the proportionality factor rather than fixing this at 25 per cent in the model.

Having the proportionality factor as a clear data input also enhances the transparency of model calculations.

7. Outputs for Reset RIN categories

We are pleased to note that the AER is intending to update the mapping in the model to the Reset RIN categories once they finalise their RIN Review, and align the RIN categories to the AER functional categories.

We would encourage the AER to adapt the standardised SCS capex model such that is able to generate all the capex reporting required to be submitted for the Reset RIN in order to streamline the resources required by the businesses in complying with data submissions and reviews.

8. Dual function and transmission assets

Ausgrid has dual function and transmission assets so we look forward to working jointly with the AER to ensure that the standardised SCS capex model can address our requirements for forecasting and mapping of our dual function and transmission assets.