

AustNet Services – Victorian
Transmission

CCP response to AER Draft
Determination

August 2016

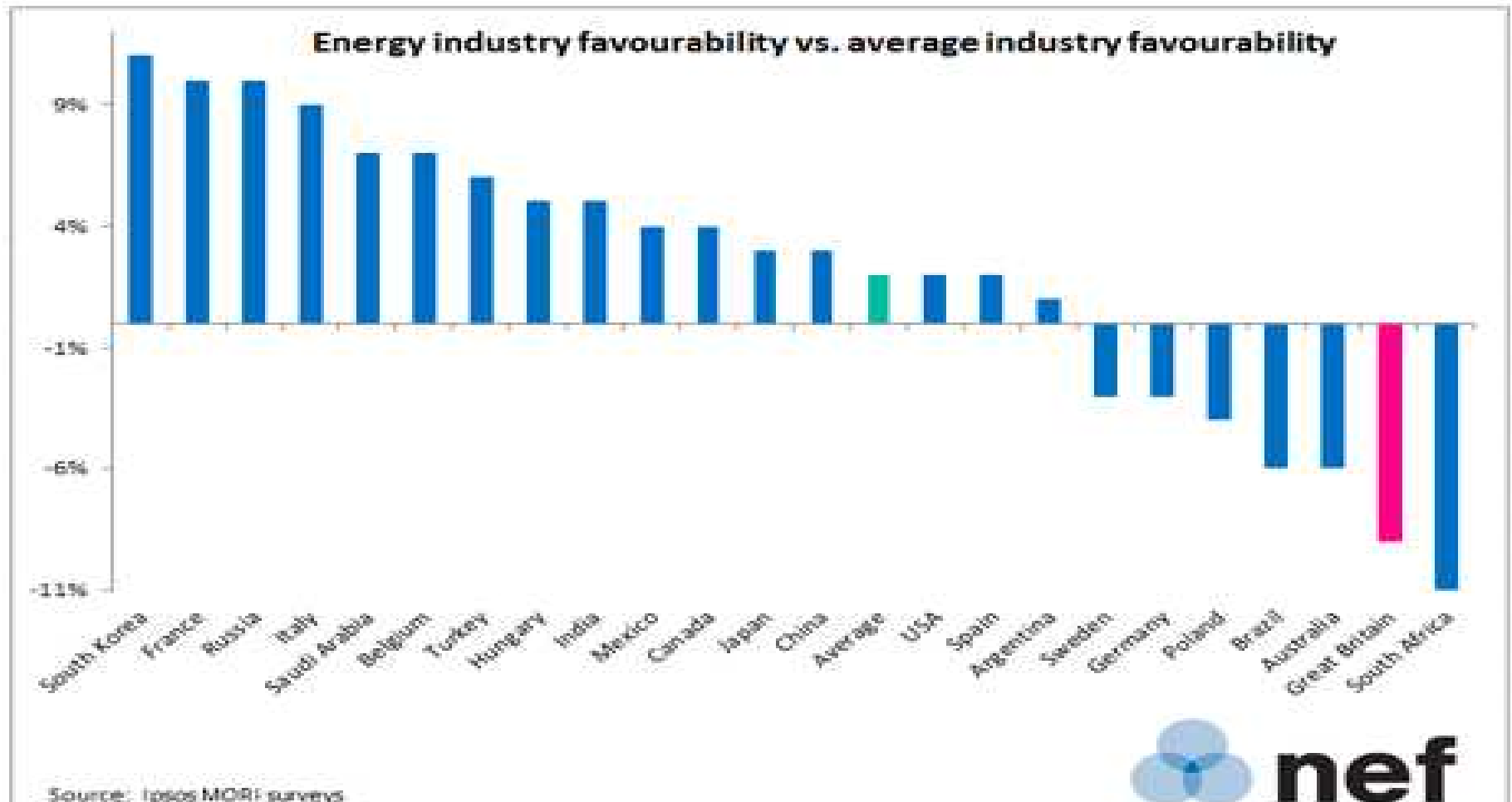
Introduction

- CCP Subpanel for AusNet Transmission comprises Ruth Lavery and Mark Henley
- Role as “Critical Friend” is to
 - Challenge AER on whether proposals meet the NEO ie. long term interests of consumers (costs, safety and reliability)
 - Advise AER whether network’s consumer engagement is effective and how it has (and should) inform proposal

Context

- “Incentive regulation” based on CPI – X incorporates expectation of reducing real costs over time.
- market returns on investments are low, CPI is low
- average demand for electricity is falling
- large numbers of households, and increasingly small business are struggling to pay their rising energy bills

Context: Trust – Australia very low trust of energy companies, compared to other companies



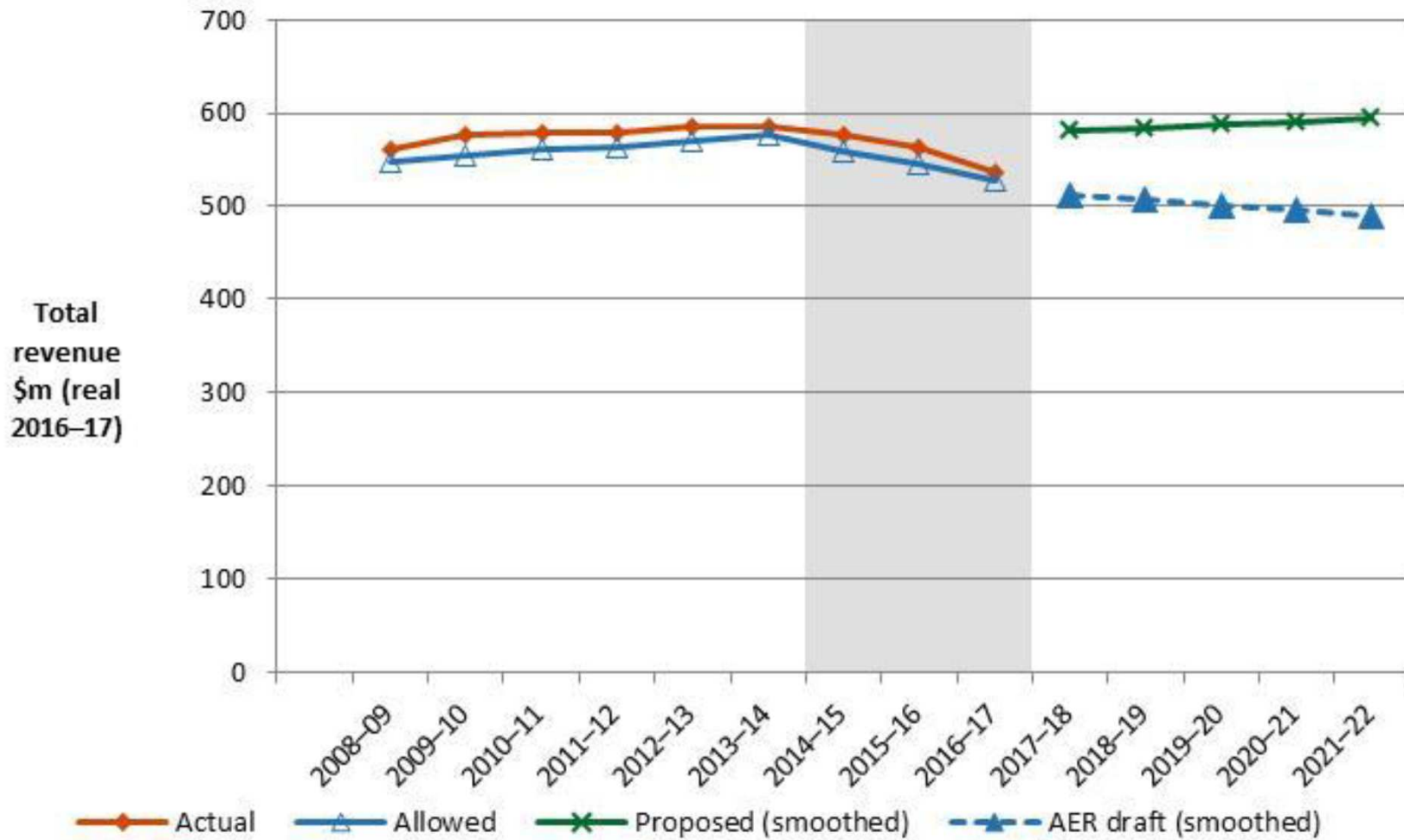
Context: Change

- Possible changes in the market
 - more renewable generation,
 - electric vehicles,
 - storage (grid and domestic scale),
 - declining aggregate demand,
 - 'micro-grids',
 - embedded networks.
 - households going 'off-grid'
- CSIRO/ENA future grid projects:
F2.5 The updated scenarios continue to reflect electricity networks performing an evolving range of critical roles to 2050, supporting diverse energy use and services for customers.

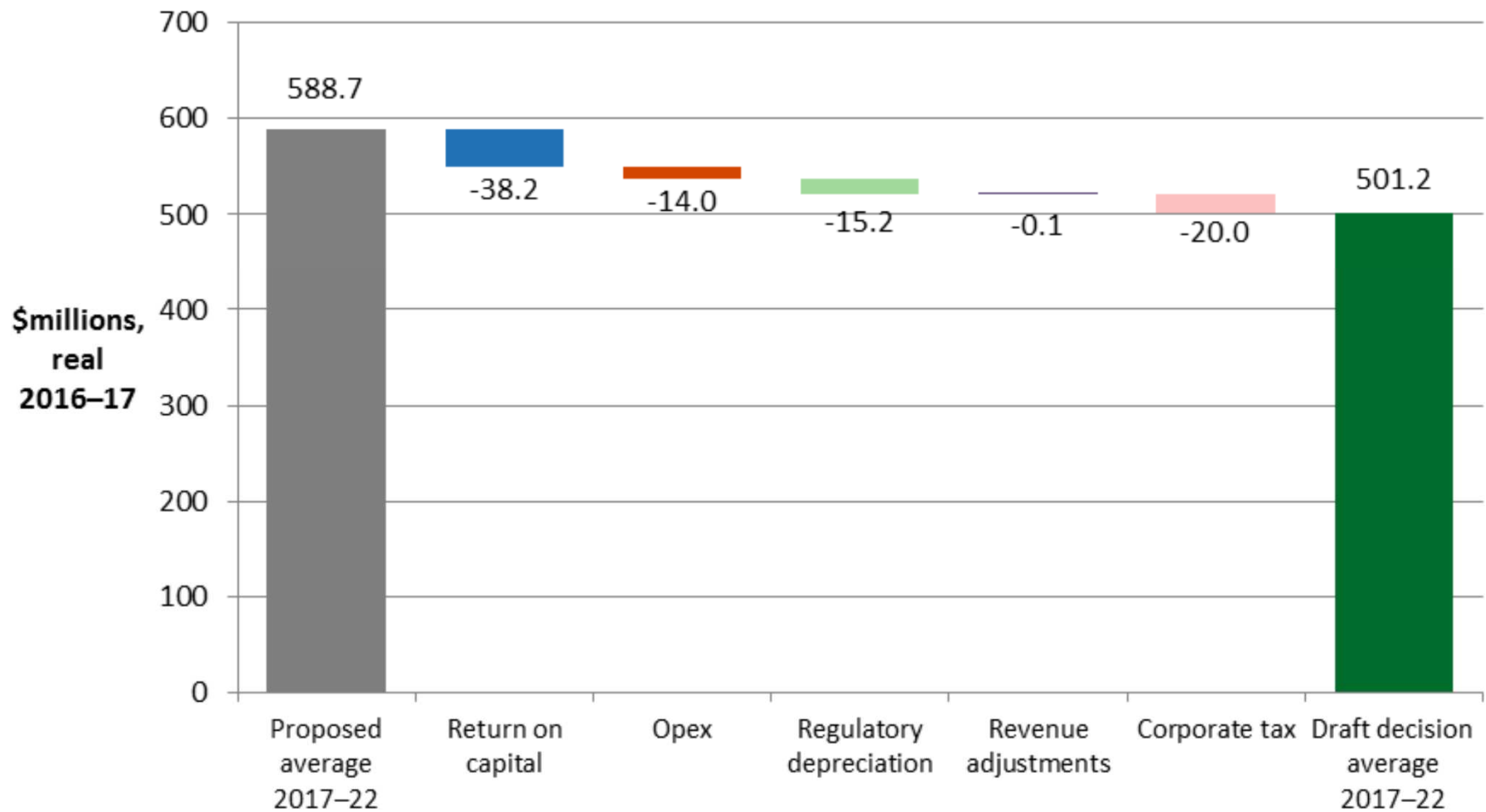
Context : change - customer uncertainty

- “Generally, there were mixed views about the future role of the transmission network. Some advocates suggested that the transmission network would have a more important role in the future, as an enabler transporting cheap renewable electricity between states. Others suggested a more diminished role, with transmission providing a ‘backbone’ between major generators and metropolitan areas, but perhaps less needed in rural areas.” (Stakeholder perceptions of accelerated depreciation Customer advocate interviews: DRAFT Report June 2016)

AER Draft Determination



Proposal → Draft Decision



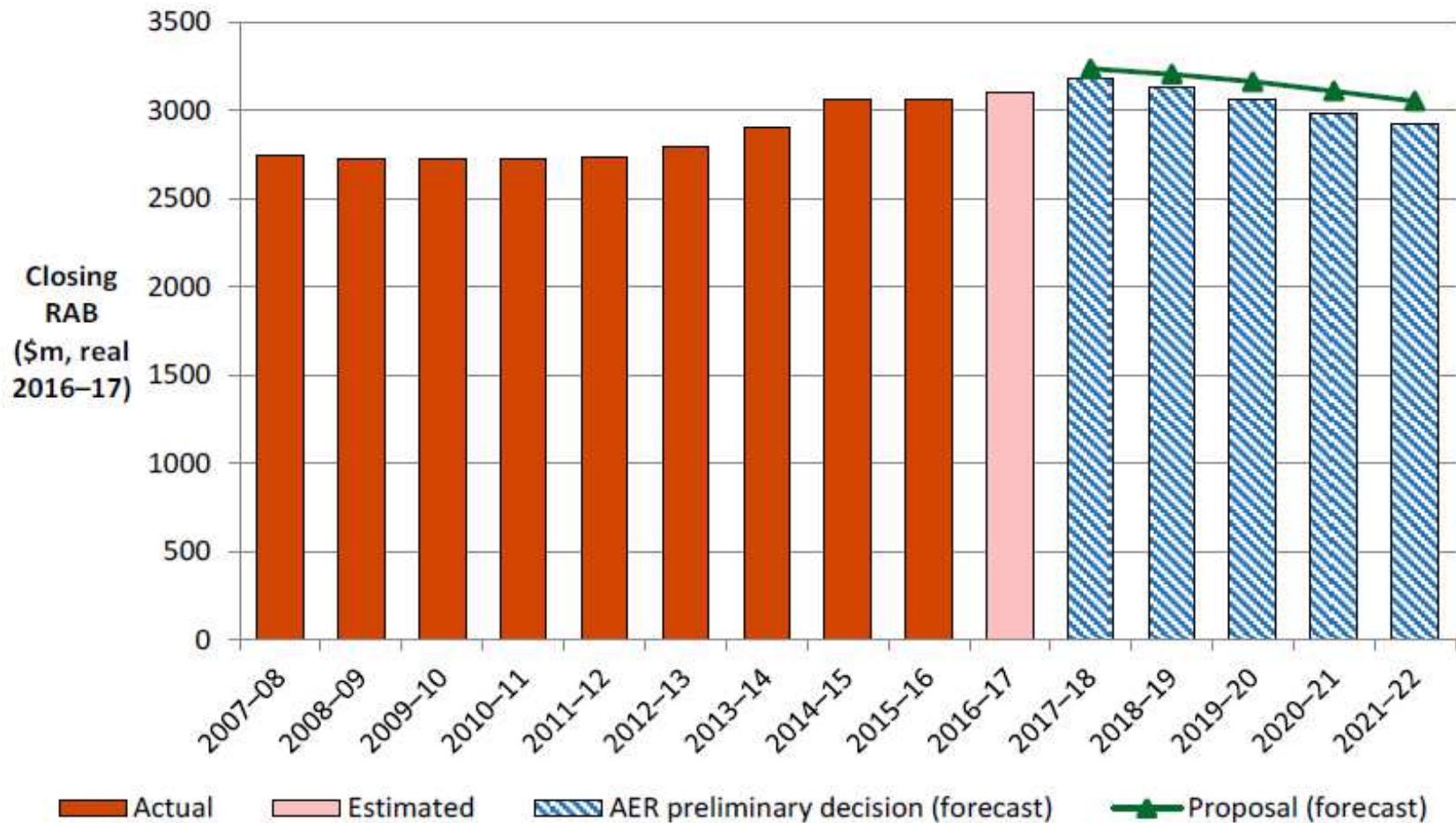
The main topics for consideration

- Return on Capital
- Corporate Tax: gamma “ γ ”
- Depreciation
- Capex
- Opex

(these are where the main impacts are)

Return on Investment

Regulated Asset Base



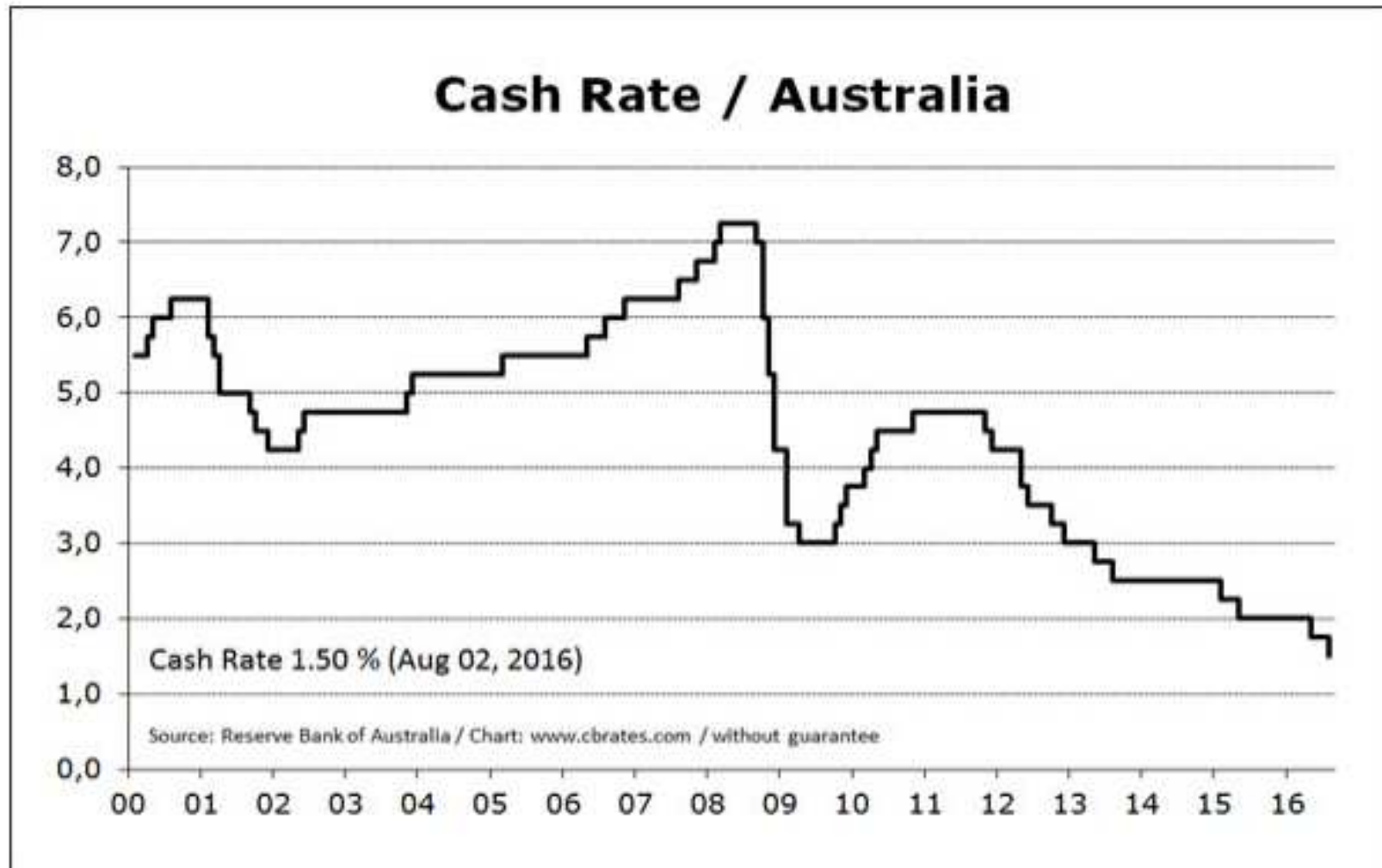
Source: AER analysis.

Rate of Return

	AER previous decision	AusNet proposal	AER draft decision	allowed return over the regulatory period
Nominal risk free rate	4.31%	3.02%	2.57%	
equity risk premium	5.20%	7.24%	4.55%	
market risk premium	6.50%	8.17%	6.50%	
equity beta	0.80	0.89	0.70	
RoE (nom post tax)	9.51%	10.00%	7.10%	constant 7.1%
Return on debt (nom post tax)	6.79%	5.37%	5.54%	updated annually
gearing	60%	60%	60%	constant 60%
WACC (nom vanilla)	8%	7.22	6.16	updated annually for debt
Forecast inflation	2.45	2.35	2.44	constant 2.44%

source AER draft decision

Interest rates – return on investment in general



Selected, current international “official” rates

CentralBanks	CurrentInterestRate	NextMeeting	LastChange
Swiss National Bank	-0.75 %	Sep 15, 07:30 GMT	Jan 15, 09:30 GMT
Bank of Japan	-0.1 %	Sep 21, 03:00 GMT	Jan 29, 03:00 GMT
European Central Bank	0 %	Sep 8, 11:45 GMT	Mar 10, 12:45 GMT
Reserve Bank of New Zealand	2.25 %	Aug 10, 21:00 GMT	Mar 9, 20:00 GMT
Bank of Canada	0.5 %	Sep 7, 14:00 GMT	Jul 15, 14:00 GMT
Reserve Bank of Australia	1.5 %	Sep 6, 04:30 GMT	Aug 2, 04:30 GMT
Federal Reserve	0.5 %	Sep 21, 18:00 GMT	Dec 16, 19:00 GMT
Bank of England	0.25 %	Sep 15, 11:00 GMT	Aug 4, 11:00 GMT

Comments

- World, and Australian interest rates are currently low, AER's WACC of 6.16% and risk free rate are, in our view, high, in that context
- Consumers and networks should bear interest rate fluctuations symmetrically
- AER's β of 0.7 is still too high, though we accept that it is the current 'standard' for determinations.
- AER's return on debt (5.54%) on the DD is higher than AusNet proposal (5.37%), there are arguments for a lower return on debt
- AusNet Rate of Return parameters were too high, for prevailing economic conditions, AER is right to reduce them – notwithstanding return on debt

Corporate Tax - Gamma

- AER initially gamma = 0.5, DD gamma = 0.4, AusNet Proposal gamma = 0.25
- There is NO 'correct' value for gamma, a uniquely Australian quirk in building block regulation
- Method matters: current approach is too restrictive from a conceptual perspective and is fraught with risk for consumers given the significant statistical issues
- Lally (for QCA): gamma = 0.83
- AER can use judgement in long term interests of consumers
- We propose AER revert to gamma 0.5

Return Of Investment

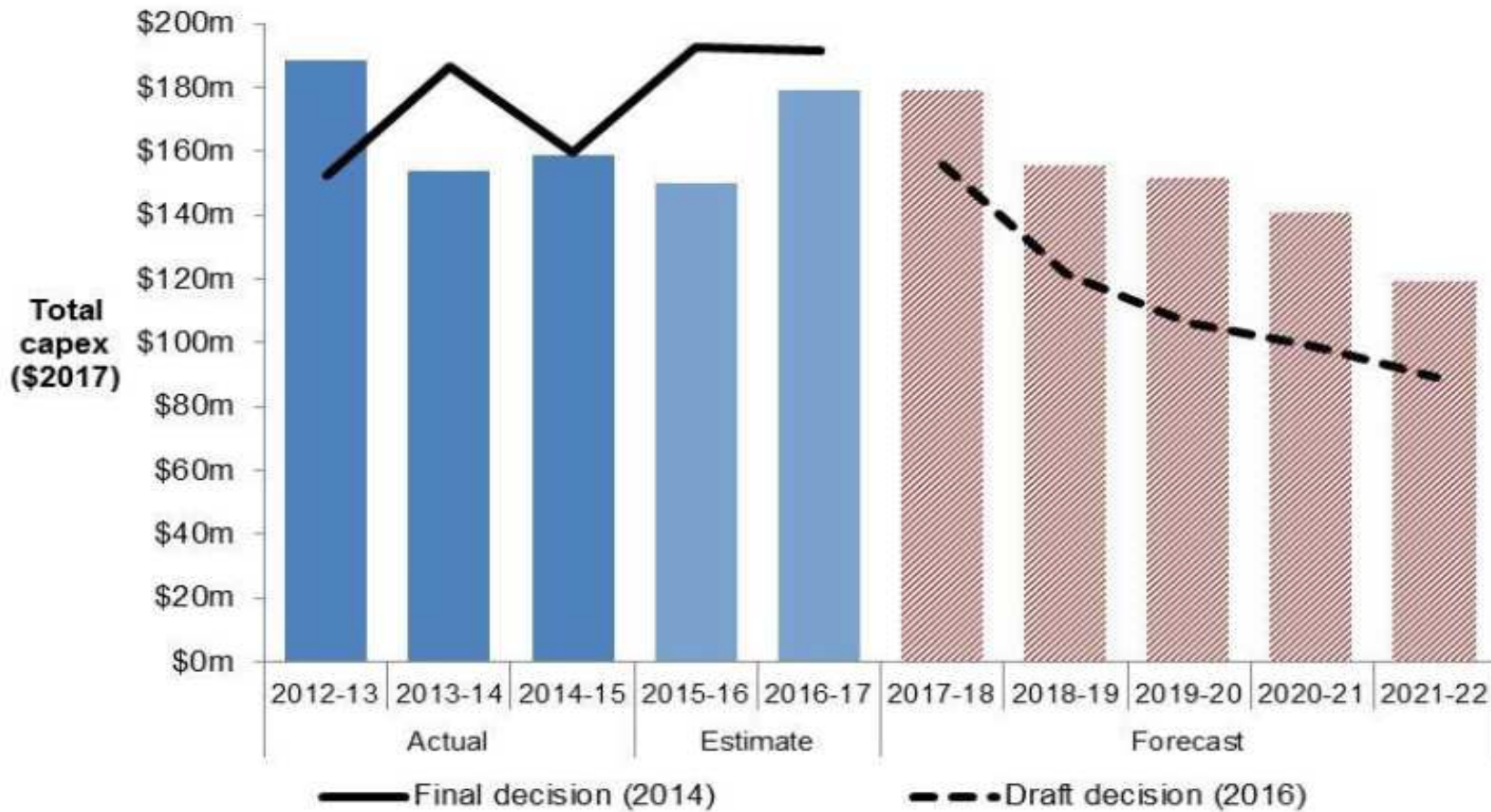
Accelerated Depreciation

- Extra consultation, qualitative research project and workshop on 7 July
- Modelling –sculpting depreciation profiles
- But underlying case not yet established
- Stakeholder perceptions of accelerated depreciation Customer advocate interviews: DRAFT Report June 2016:
 - “ambiguity in findings highlights the complexity of this issue” or maybe ambiguity is because there is not yet a real case for accelerated depreciation? Qualitative research should disentangle
 - Accelerated depreciation will “improve intergenerational equity by reducing the cost burden on the future customer base” but advocates also not keen on intergenerational equity.
- What is the problem that is being solved?

Capital Expenditure

Capital Expenditure

Figure 3.3 AusNet Services total actual and forecast capex 2014–2022

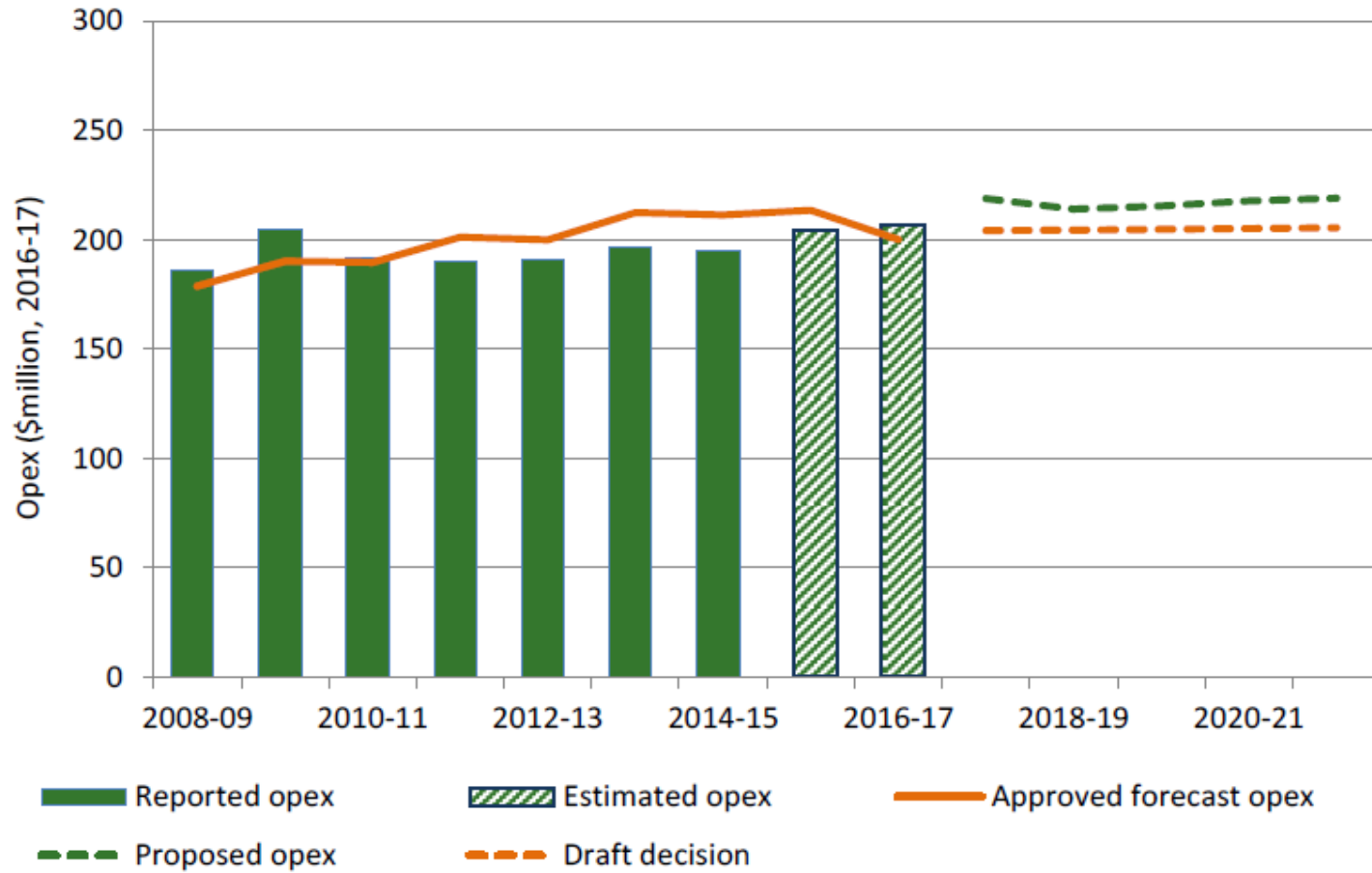


Capex

- Regulatory framework = building block approach to finding efficient revenue
- Bucket of funds results, and it is network decision where to spend the bucket. The link between expenditures and revenue is broken once the regulatory revenue is set.
- Safety – be clear on who is responsible. Electricity customers should only bear costs that are an obligation of the network, not those of other agencies. Avoid double-counting.

Operating Expenditure

Opex



source: AusNet Services, *Regulatory accounts 2008–09 to 2014–15*; AusNet Services, *Economic benchmarking - Regulatory information notice response 2006 to 2015*; AER analysis.

Opex

- Decommissioning step change
- Large, but not unexpected
- Understanding and expecting changes to the Australian economy are part of network's business
- Not new obligations as foreseen by the AER's Expenditure Forecast Assessment Guideline for Electricity Distribution

Consumer Engagement

(Dec 2015) We Said ...

- AusNet has made genuine effort to effectively engage with a breadth of consumer interests.
- Concerned that consumer advice re Accelerated Depreciation was apparently ignored:
 - “Participants were strongly against the application of any type of accelerated depreciation.” (pg 53, proposal)*
- Use of IAP2 model: great, but where is the “Promise to the Public?”

IAP2'S PUBLIC PARTICIPATION SPECTRUM



The IAP2 Federation has developed the Spectrum to help groups define the public's role in any public participation process. The IAP2 Spectrum is quickly becoming an international standard.

INCREASING IMPACT ON THE DECISION 

	INFORM	CONSULT	INVOLVE	COLLABORATE	EMPOWER
PUBLIC PARTICIPATION GOAL	To provide the public with balanced and objective information to assist them in understanding the problem, alternatives, opportunities and/or solutions.	To obtain public feedback on analysis, alternatives and/or decisions.	To work directly with the public throughout the process to ensure that public concerns and aspirations are consistently understood and considered.	To partner with the public in each aspect of the decision including the development of alternatives and the identification of the preferred solution.	To place final decision making in the hands of the public.
PROMISE TO THE PUBLIC	We will keep you informed.	We will keep you informed, listen to and acknowledge concerns and aspirations, and provide feedback on how public input influenced the decision. We will seek your feedback on drafts and proposals.	We will work with you to ensure that your concerns and aspirations are directly reflected in the alternatives developed and provide feedback on how public input influenced the decision.	We will work together with you to formulate solutions and incorporate your advice and recommendations into the decisions to the maximum extent possible.	We will implement what you decide.

Since Then ...

- Genuine efforts to engage with consumers continues, and we opine: “improves.”
- Discussion paper re Accelerated Depreciation followed up with presentation and forum re “Stakeholder perceptions of Accelerated Depreciation,” stakeholder forum in June 2016, so recent. Keen to hear what AusNet took out of this forum and the process overall.
- “Promise to Public” at ‘inform’ level and well on the way re ‘consult’ level; ie *“We will keep you informed, listen to and acknowledge concerns and aspiration (still to come *), and provide feedback on how public input influenced the decision. (We anticipate this in the revised proposal), We will seek your feedback on drafts (yes) and proposals (emerging)”*

* CCP comments in brackets

Other Matters

Incentive Schemes

The Incentive schemes that will apply:

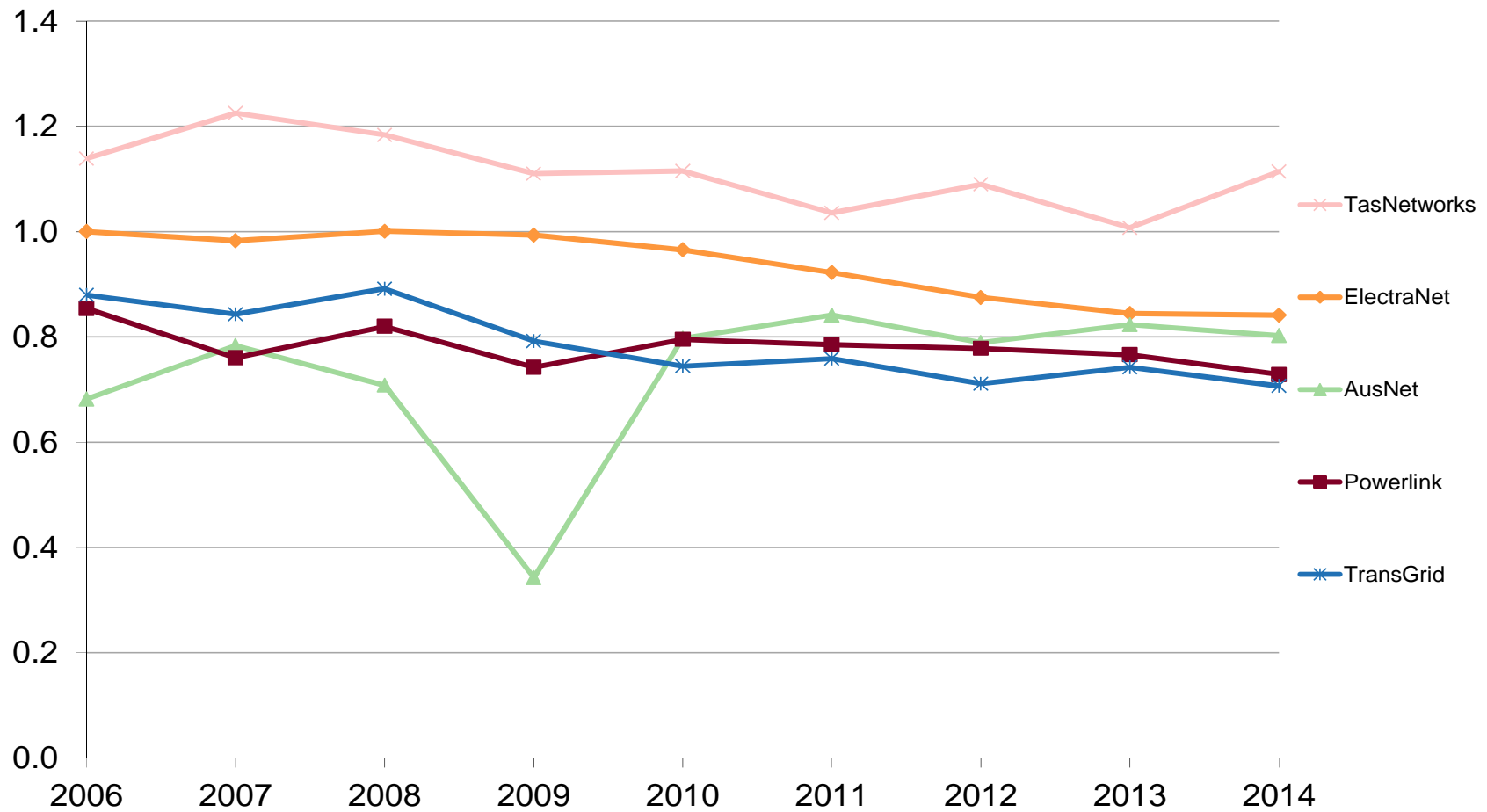
- Efficiency Benefit Sharing Scheme (EBSS)
With \$5.1m carry over, version 2 of EBSS to apply for 2017-22
- Capital Expenditure Sharing Scheme (CESS)
Version 1 to apply
- Service Target Performance Incentive Scheme (STIPIS)
Version 5 to apply
(Note CCP5 is yet to check the parameters applied in the DD)

All parties seem to agree with application of the “micro” incentive schemes.

No issue here

Multilateral Total Factor Productivity by TNSP for 2006–14.

Static / declining or improving?



Range of Futures not actively considered

- Earlier notes finding from CSIRO/ENA roadmap

“The updated scenarios continue to reflect electricity networks performing an evolving range of critical roles to 2050, supporting diverse energy use and services for customers.”

- We suggest that AusNet is not so sure about its longer term role, their narrative seems to be underscored by shorter term pessimism with minimal consideration of the longer term scenarios, that others point to.

Thank you

