# AER Public Forum - 9th July 2014

# Consumers' Perspectives on Transend's Revenue Proposal

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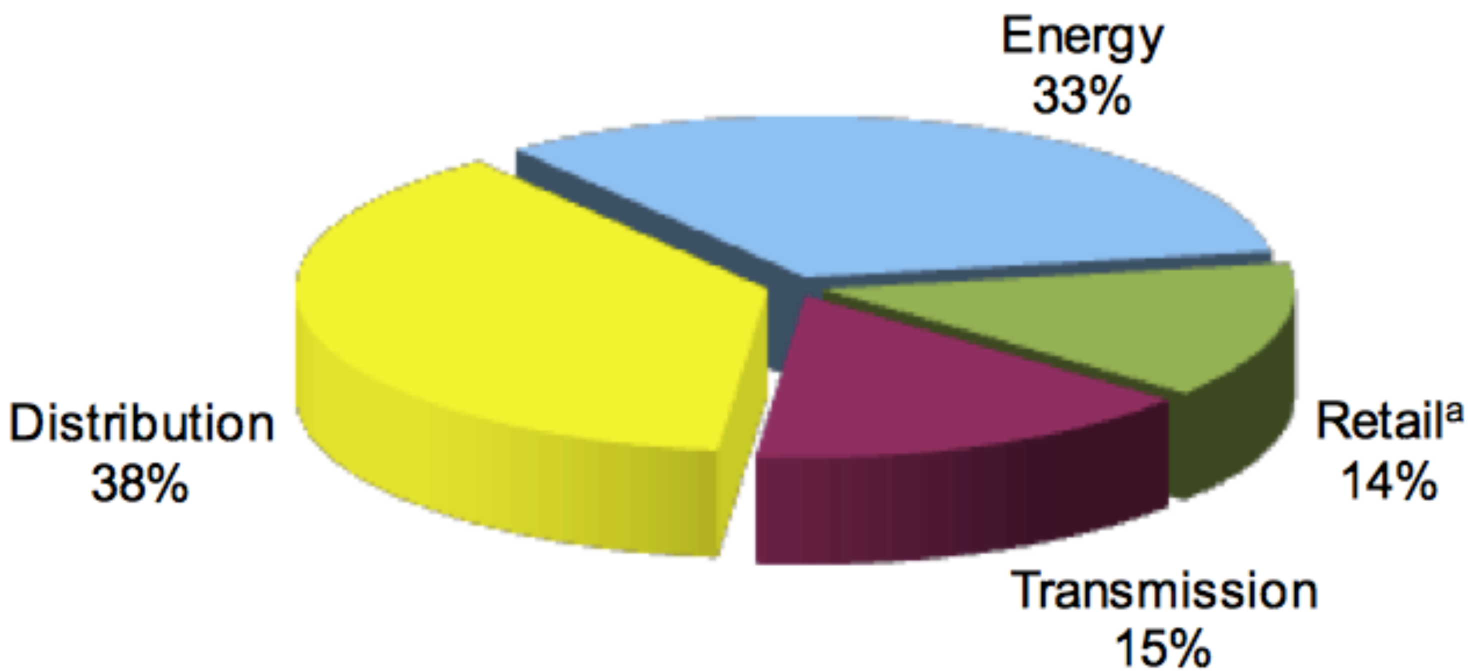
# RECENT ELECTRICITY PRICE INCREASES

# Recent Electricity Price Increases

- Australia's electricity prices have risen rapidly in recent years and are of major concern to consumers
- It is now well understood that a major driver of the price increases has been increasing network charges from the monopoly electricity networks
- Numerous reviews have concluded that a large proportion of the price increases were unnecessary and arose from deficiencies in the regulatory framework
- These deficiencies resulted in the Australian Energy Regulator (AER) approving excessive rates of return, over-investment and inefficient expenditure on electricity network infrastructure

# Tasmanian Electricity Prices - Key Components

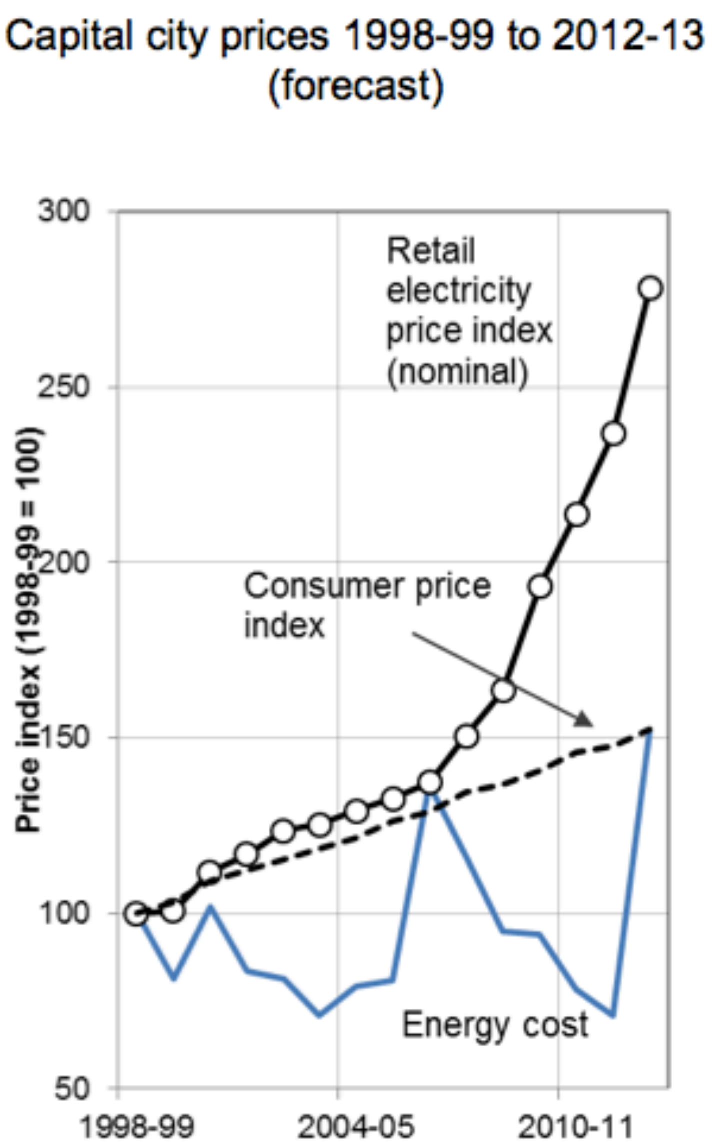
**Figure 2.1 Price components of a typical electricity bill**[4]

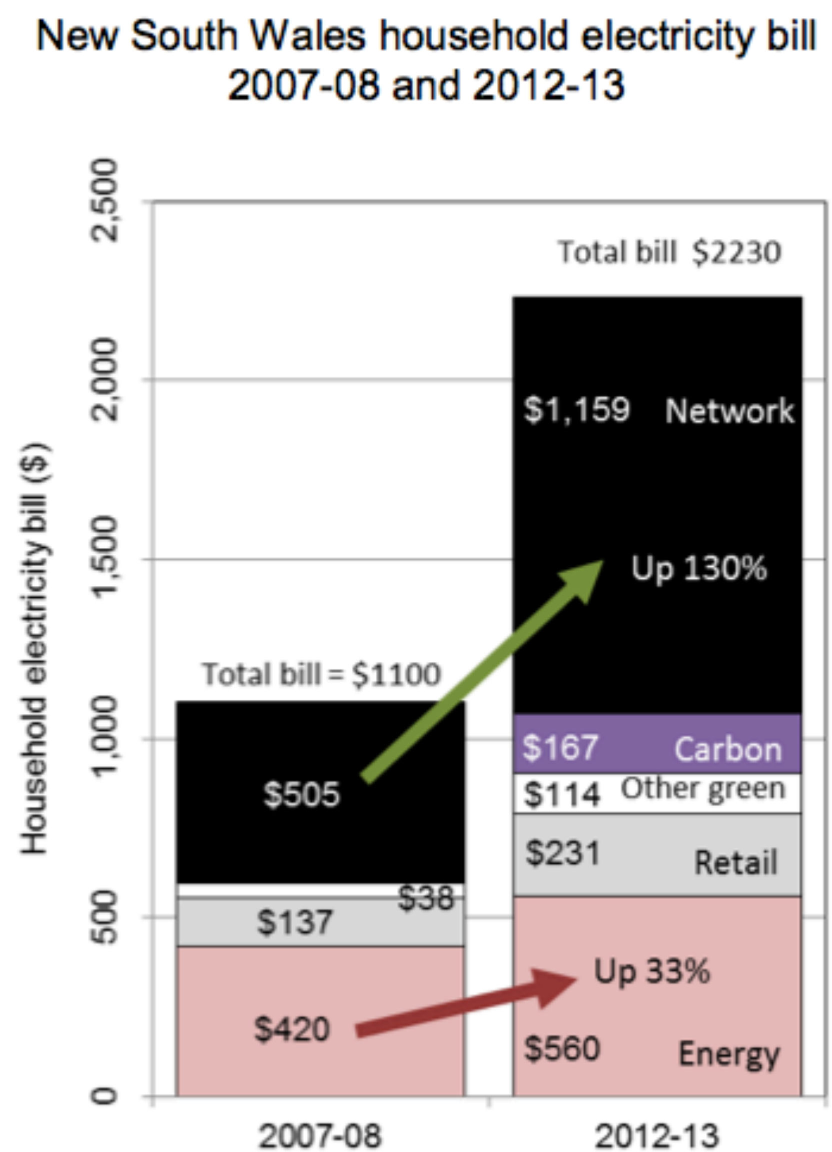



[a] Includes Renewable Energy Target costs of and Australian Energy Market Operator market charges

Source: Otter - Comparison of 2014 Australian Standing Offer Energy Prices

# Electricity Price Increases

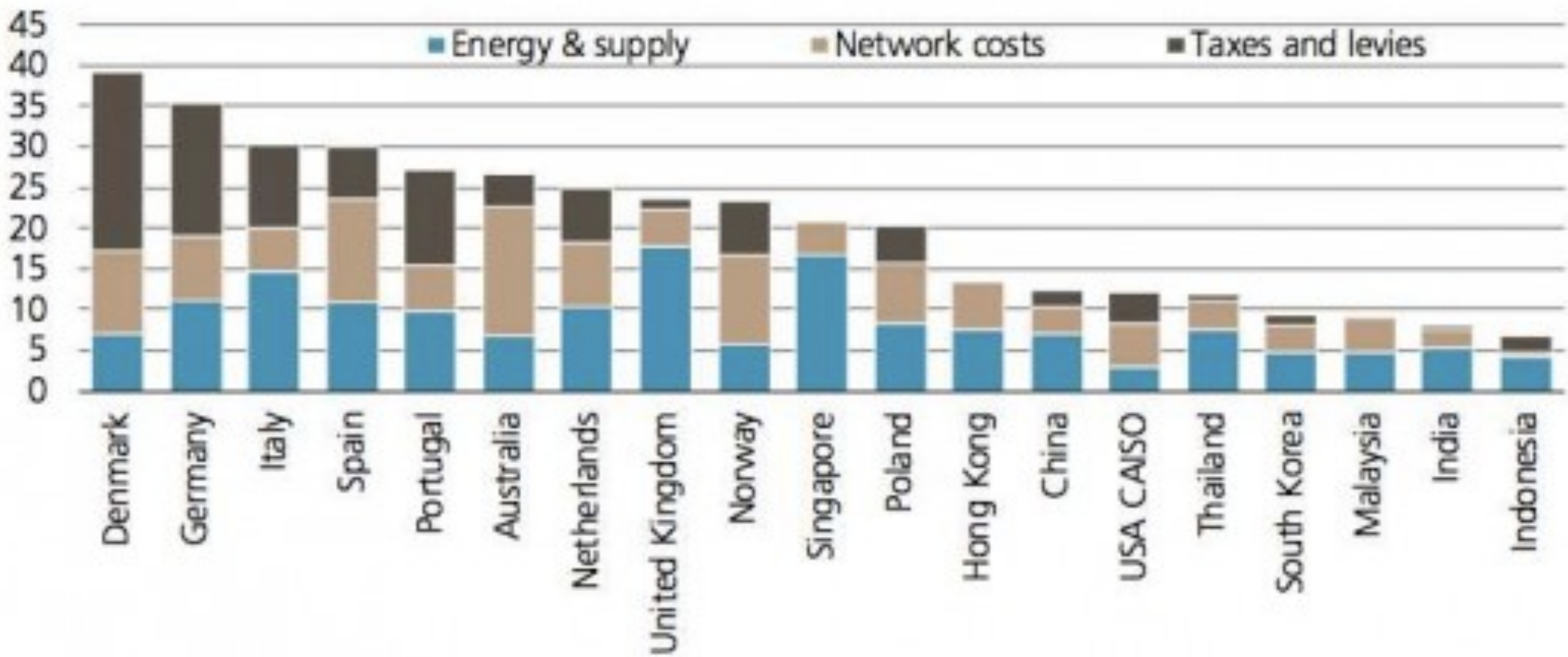



Source: Productivity Commission Inquiry Report - Electricity Network Regulatory Frameworks

# International Electricity Prices

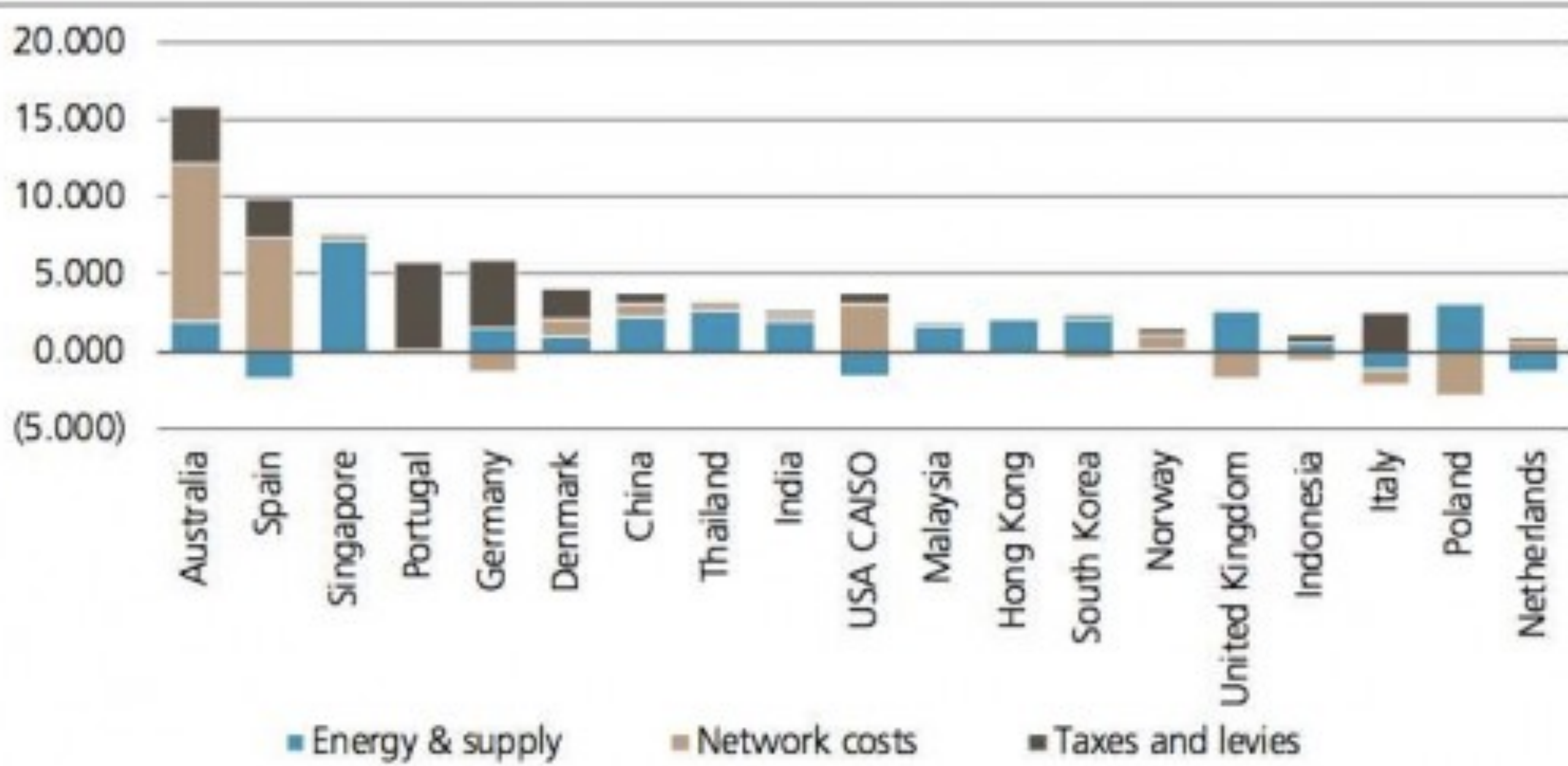
**Figure 1: 2013 tariffs (US cents per kWh)**




Note: Residential tariffs for Australia, Europe and the US; national average for Asian markets.
Source: Power utility companies, government databases, UBS estimates

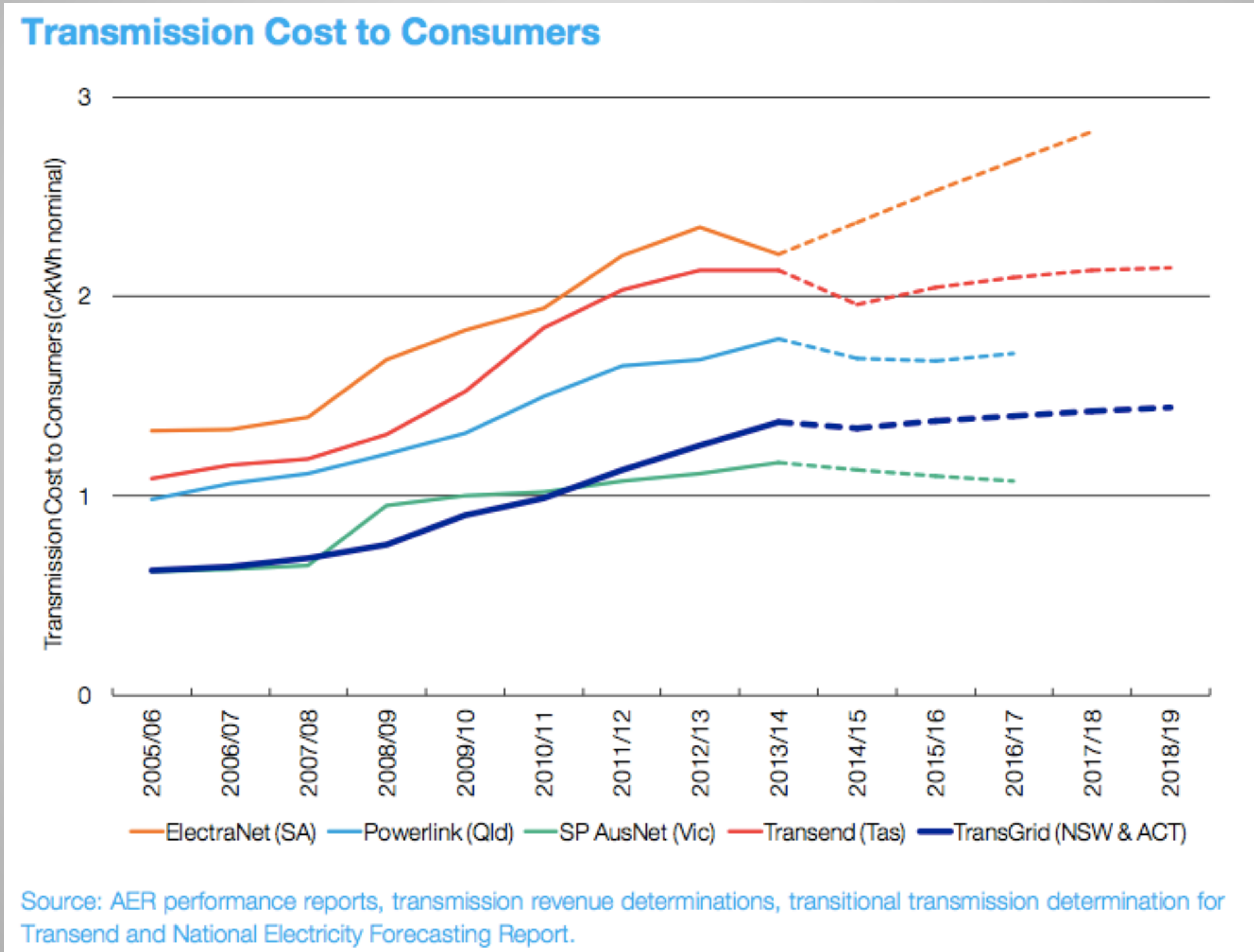
# Recent **Growth** in International Electricity Prices

Figure 5: US cents per kWh change in power prices 2007-13

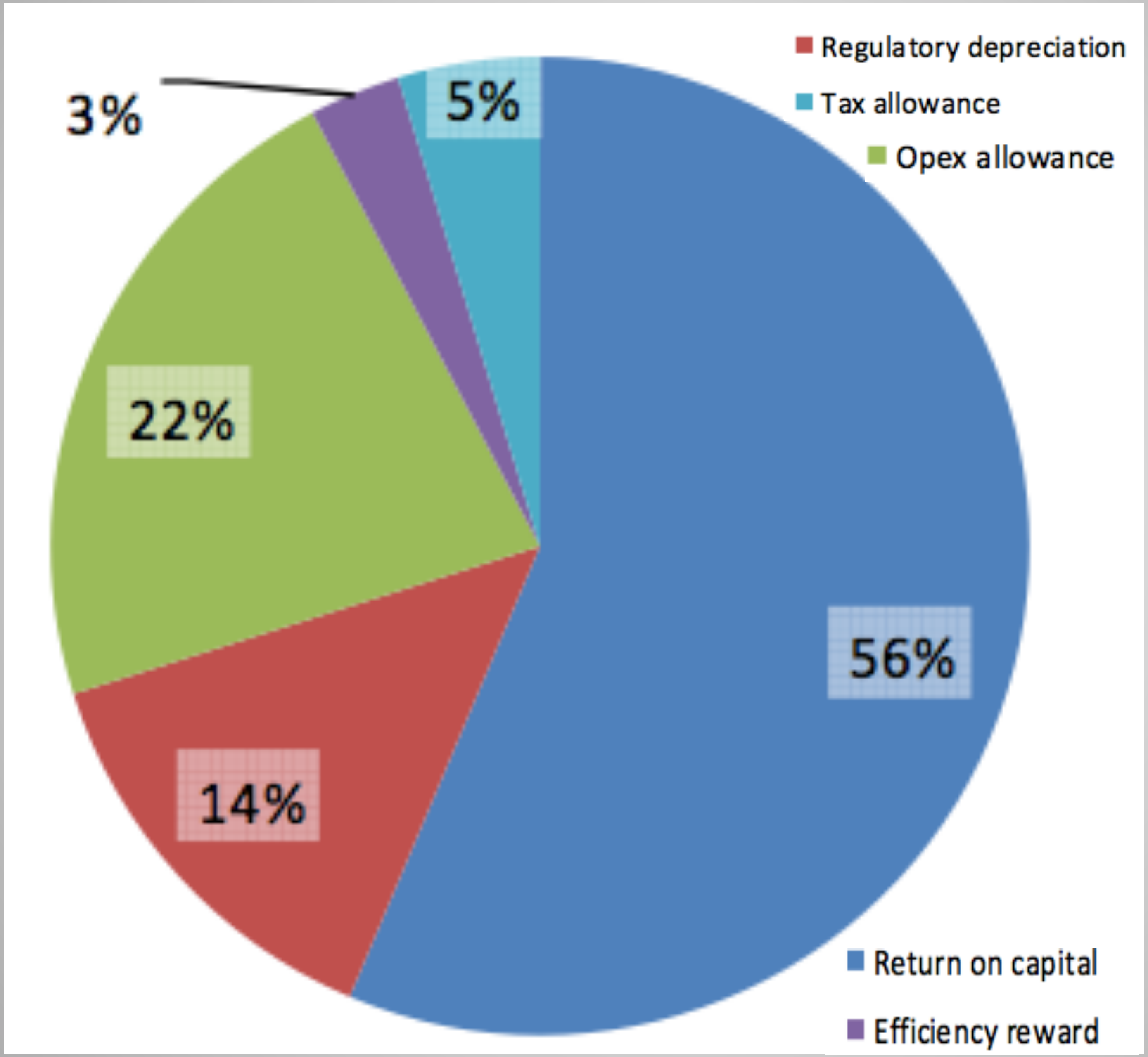



Source: Power utility companies, government databases, UBS estimates

# Trend in Australian Transmission Prices (c/kWhr)



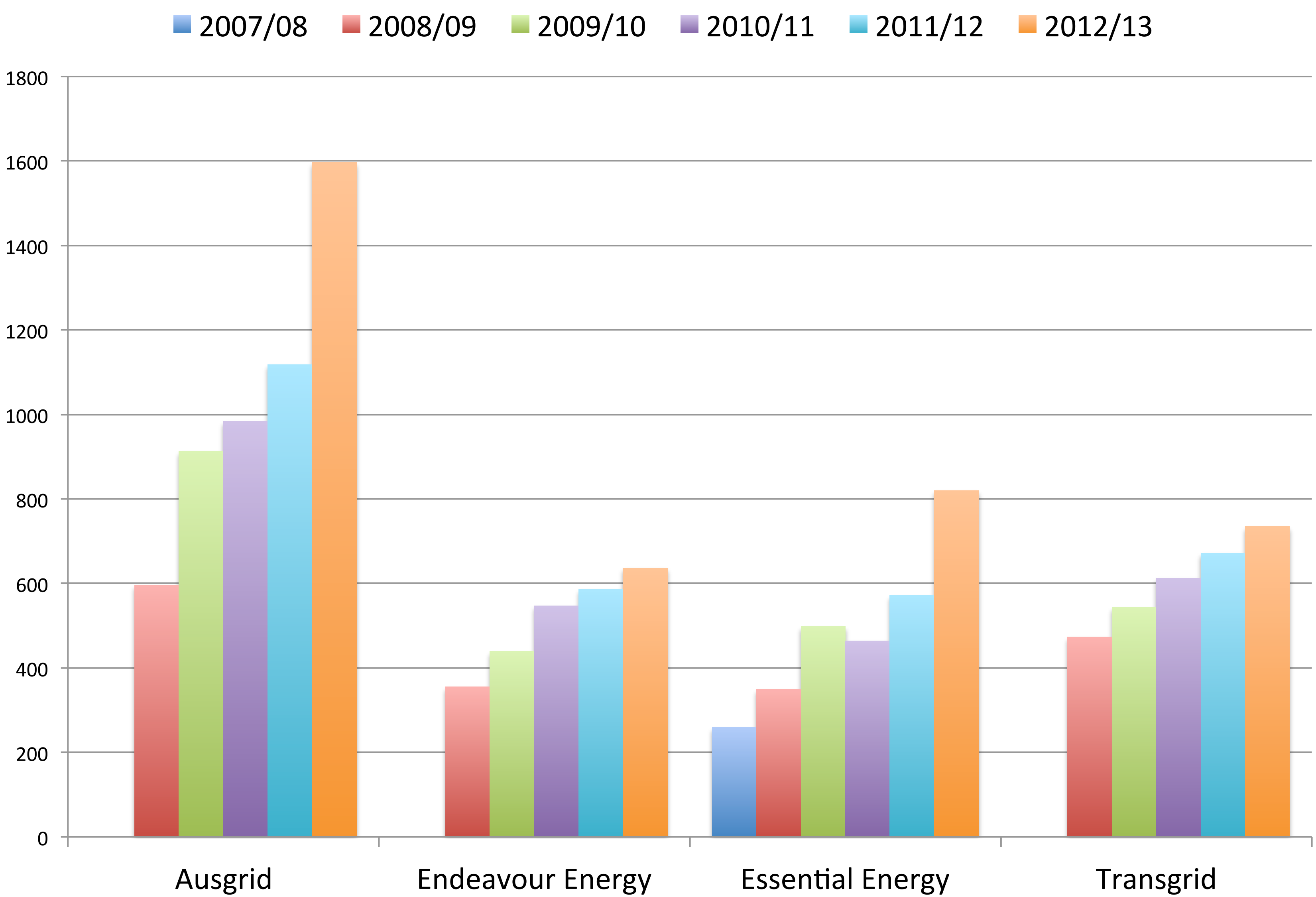
# Transend - Revenue Components




Source:
AER Transitional Decision

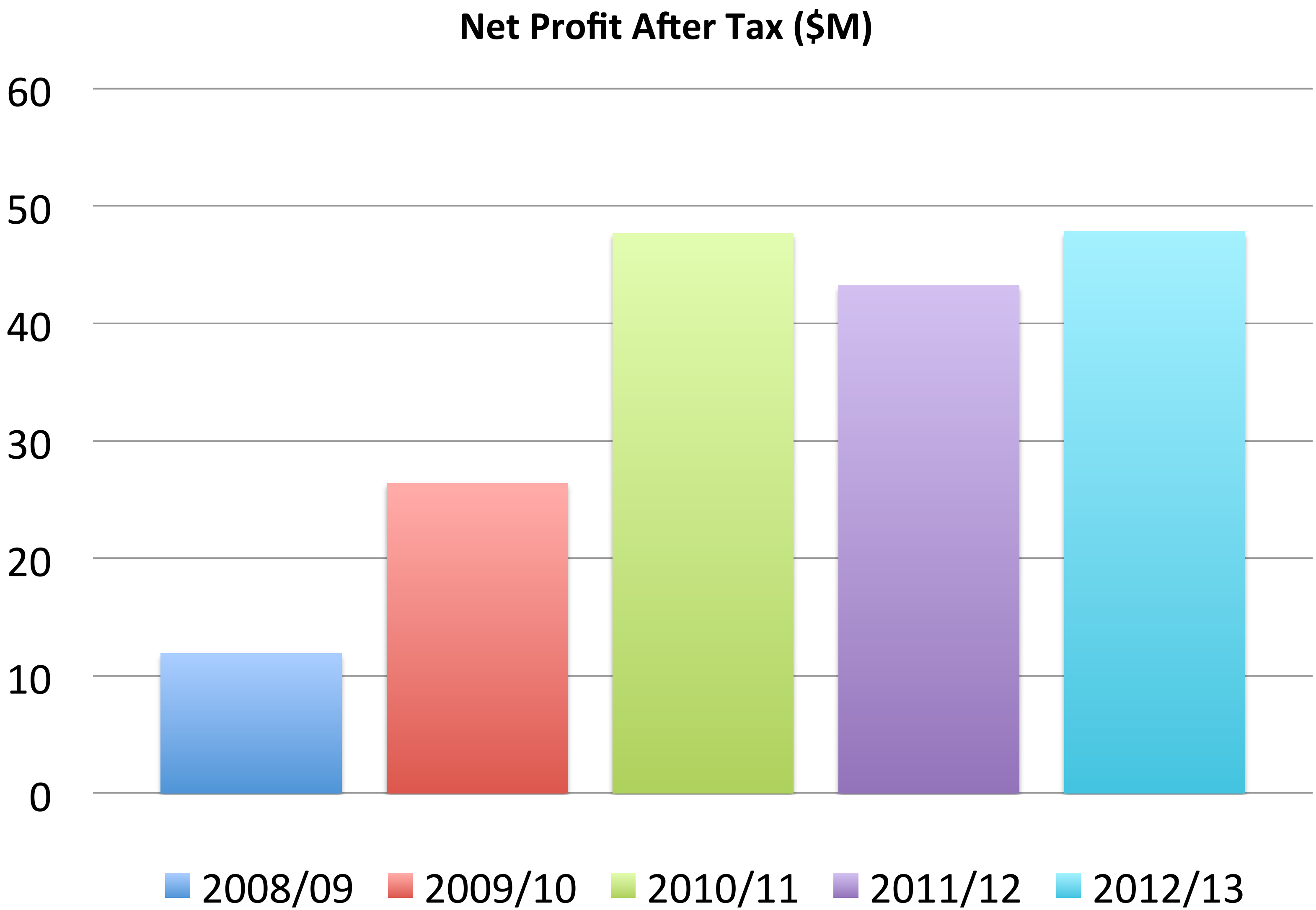
# RECENT PROFITABILITY GROWTH

# NSW Networks - Recent Profitability Growth



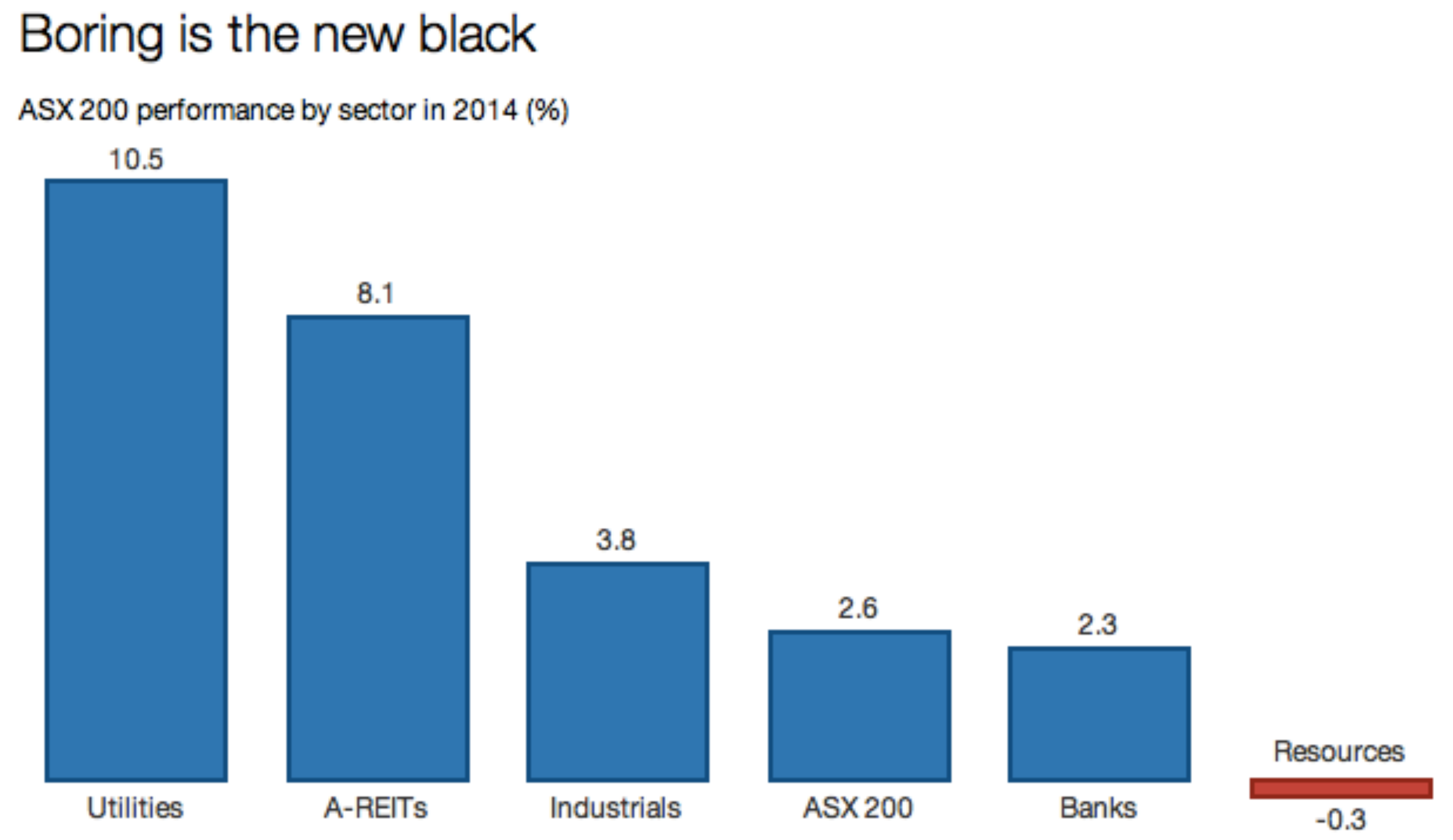

Source: NSPs' Annual Reports (EBIT for DNSPs, EBITDA for TransGrid)

# Transend - Recent Profitability Growth




Source: Transend Annual Reports

# Utilities - Best Performing Sector in the ASX 200




Source: "Boring but Bankable – Meet Australia's Best Performing Sector" – SMH Article (26/05/14)

# RECENT REGULATORY REFORMS

# Regulatory Rule Changes - November 2012

- In response to proposals by the AER and the Energy Users' Rule Change Committee (EURCC), the AEMC undertook an investigation into the effectiveness of the regulatory framework
- The review involved extensive stakeholder consultation and resulted in amendments to the National Electricity Rules in November 2012
- The changes were aimed at **“strengthening the capacity of the regulator to determine network prices so that consumers don’t pay any more than necessary for the reliable supply of electricity and gas”**
- The rule changes were informed by numerous submissions from stakeholders, including public forums, workshops, and expert reviews

# Regulatory Rules - Key Changes

## New ‘Rate of Return’ Framework

- Aimed at improving the ability of regulator to make the best possible estimate of the rate of return at the time a regulatory determination is made
- Requiring the regulator to undertake an open and consultative process at least every three years to develop its approach to setting the rate of return

## New Capital Expenditure Incentives

- New regulatory tools, such as capital expenditure sharing schemes and efficiency reviews, enabling the regulator to incentivise the networks to invest capital efficiently

## New Capex and Opex Review Powers

- Rules that improve the clarity and remove ambiguities regarding the powers of the regulator to interrogate, review and amend capital and operating expenditure proposals
- Rules that require the regulator to publish annual benchmarking reports to assess the relative efficiencies of network businesses

## Extended Regulatory Determination Process

- Lengthened by four months to enhance stakeholder involvement - particularly by consumer representatives

# The AER's *Better Regulation* Program

- The AER conducted a 12-month program – the *Better Regulation Program*, to determine how the rule changes should be implemented
- This involved the development of a suite of guidelines and methodologies to provide a new framework for the AER's regulatory decisions, e.g.:
  - Rate of Return Guideline
  - Consumer Engagement Guideline
  - Expenditure Assessment Guidelines
  - Capital Expenditure Incentives Guideline
  - Consumer Engagement Guideline

# Strengthened Consumer Involvement

- A key objective of the regulatory reforms was to provide consumers with a greater voice in regulatory determinations
- The new rules require the AER to take into account the quality of the network businesses' consultation with consumers in developing their regulatory proposals
- The revenue determination process has been lengthened by 4 months to provide more time for consumers to prepare submissions and to put their views forward
- The AER is planning consumer meetings and public forums during each key phase of the revenue determination process

# APPLICATION OF THE NEW RULES

# CURRENT STATUS

# The AER's Implementation of the New rules

- The AER will be applying the new rules to 17 network revenue determinations over the next 2 years
- The Transend determination is one of the "first cabs off the rank" in the application of the new rules
- The recent rule changes delayed the commencement of the Transend determination
- Transitional Rules have been implemented to allow an expedited transition to the new rules, involving:
  - A 'streamlined' review (Jan-April 2014), to enable the regulator to determine Transend's 'transitional revenue' for 2014/15
  - A full review (May 2014 - April 2015) for the regulator to determine Transend's 5 year revenues
- The 2014/15 placeholder revenue will be subjected to a "true-up" when the final determination is completed in April 2015

## Transend Determination – Key Dates

| KEY PHASES AND STEPS | TIMEFRAMES |
|---|---|
| **Transitional Proposal Phase** | |
| DNSPs to submit Transitional Proposals | 31 January 2014 |
| AER to publish the Transitional Proposals | February 2014 |
| AER meeting with NSW consumer groups to run through the Transitional Proposals | February 2014 |
| Submissions on the Transitional Proposals close | Feb/March 2014 |
| AER to finalise the 2014/15 Placeholder Determination | 30 April 2014 |
| **Revenue Proposal Phase** | |
| DNSPs to submit Revenue Proposals | 31 May 2014 |
| AER to publish the DNSP Revenue Proposals | June 2014 |
| AER to publish "Issues Papers" to guide public submissions on the revenue proposals | June 2014 |
| AER Meeting with NSW consumer groups to run through the revenue proposals | July 2014 |
| AER Public Forum on the revenue proposals | July 2014 |
| Submissions on revenue proposals close | August 2014 |
| **Draft Determination Phase** | |
| AER Draft Determinations published | 30 November 2014 |
| AER Public forum on the draft determinations | December2014 |
| Submissions on the draft determinations close | January 2015 |
| **Revised Revenue Proposal Phase** | |
| DNSPs to submit Revised Revenue Proposals | January 2015 |
| AER to publish the DNSPs' Revised Revenue Proposals | January 2015 |
| AER Public forum on the Revised Revenue Proposals | February 2015 |
| Submissions on the Revised Revenue Proposals close | February 2015 |
| **Final Determination Phase** | |
| AER Final Determinations published | 30 April 2015 |

# Revenue Determinations - Current Status

- The NSW/ACT DNSPs and NSW/Tasmanian TNSPs submitted their Transitional Proposals on 31st January, and submitted their full (5 year) revenue proposals on the 31st May
- The AER made its *Transitional Decisions* on the 30th April
- Due to time and information constraints, the AER restricted its assessment of the Transitional Proposals to 'Return on Capital' (WACC) issues
- The AER did **not** assess the other key elements of the Transitional Proposals (capex, opex, etc.) - simply treating them as 'inputs' for the purpose of determining 'placeholder revenues' for 2014/15

# APPLICATION OF THE NEW RULES

# WHAT ARE WE SEEING SO FAR?

# What should consumers expect from the new rules?

- Revenue Proposals driven by:
  - Consumers' long term interest
  - Consumers preferences and willingness to pay for those preferences
- Significant price reductions, due to:
  - Major reductions in the cost of capital (WACC)
  - Minimal capex
  - Lower opex
  - Equitable performance incentive schemes
- Networks adhering to the new AER regulatory guidelines
- A stronger, more proactive regulator

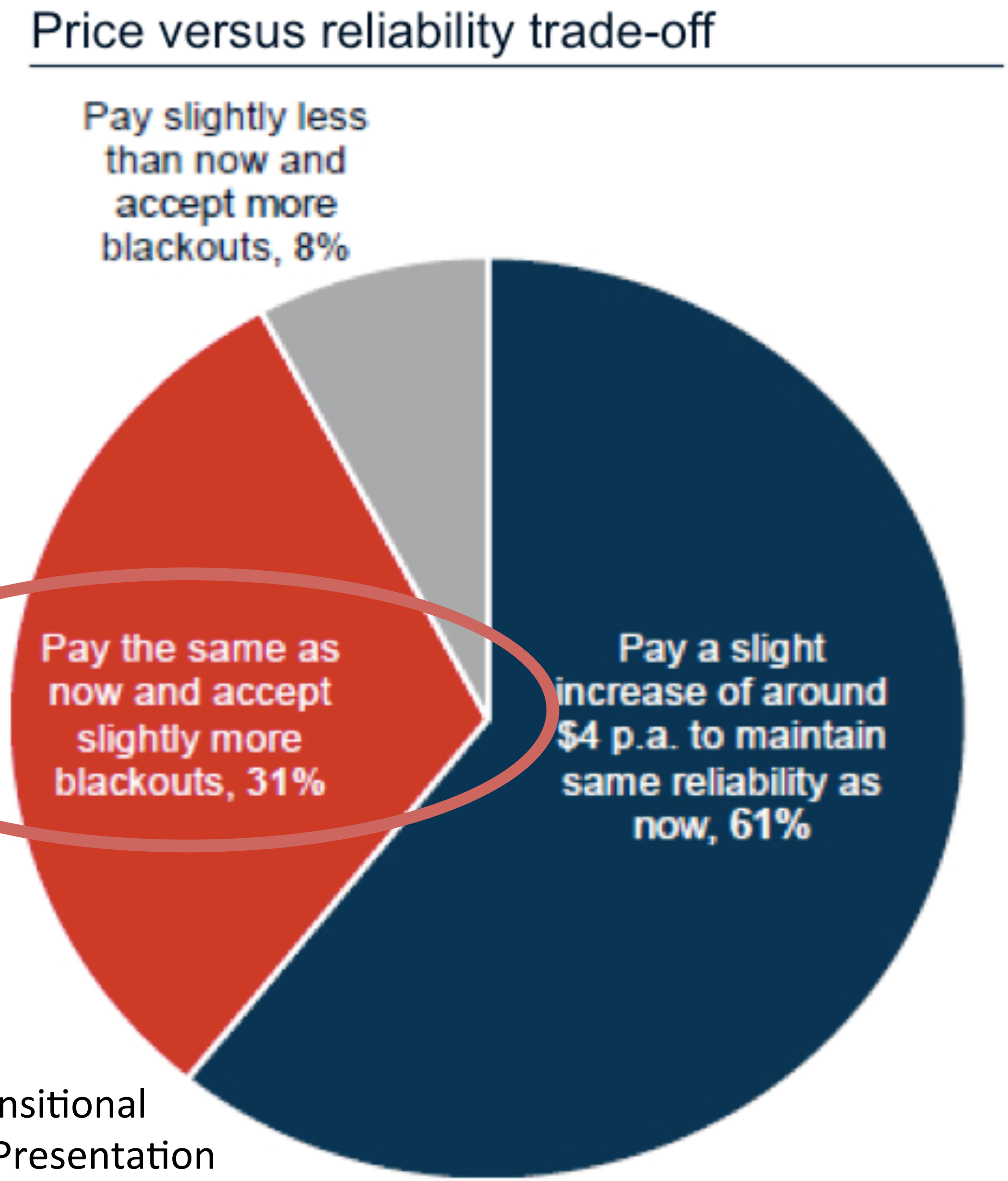
| What should consumers expect? | What are we seeing so far? |
|---|---|
| Revenue proposals driven by<br>▪ Consumers' long term interest<br>▪ Consumers preferences and willingness to pay for those preferences | ▪ Proposals predominantly driven by the networks' interests<br>▪ Tokenistic, "push poll" driven consumer engagement<br>▪ Non-credible claims regarding consumers preferences and willingness to pay |
| Significant price reductions, due to:<br>▪ Major reductions in WACC<br>▪ Minimal capex<br>▪ Lower opex<br>▪ Equitable performance incentive schemes | ▪ Excessive WACCs proposed<br>▪ Excessive, unjustified capex<br>▪ Significant, unjustified opex increases<br>▪ Incentive schemes heavily biased to networks' interests |
| Networks adhering to the new regulatory guidelines | Most networks challenging the legality of the new regulatory guidelines |
| A stronger, more proactive regulator | ? |

# CONSUMER ENGAGEMENT

# Consumer Engagement

- Consumers seriously question the validity of the key conclusions that most networks are claiming from their consumer engagement programs
- Most networks' consumer engagement to date has been "push poll" driven, and has not transparently communicated the cost and price implications of the "consumer preferences" being claimed
- Consumers expect the AER to seriously challenge the networks to provide clear evidence of all of their claims regarding consumer preferences - **including evidence of consumers' willingness to pay for those preferences**
- Consumers also expect the AER to assess the value for money of the networks' consumer engagement programs, and to outline their expectations regarding improvements to the networks' approaches

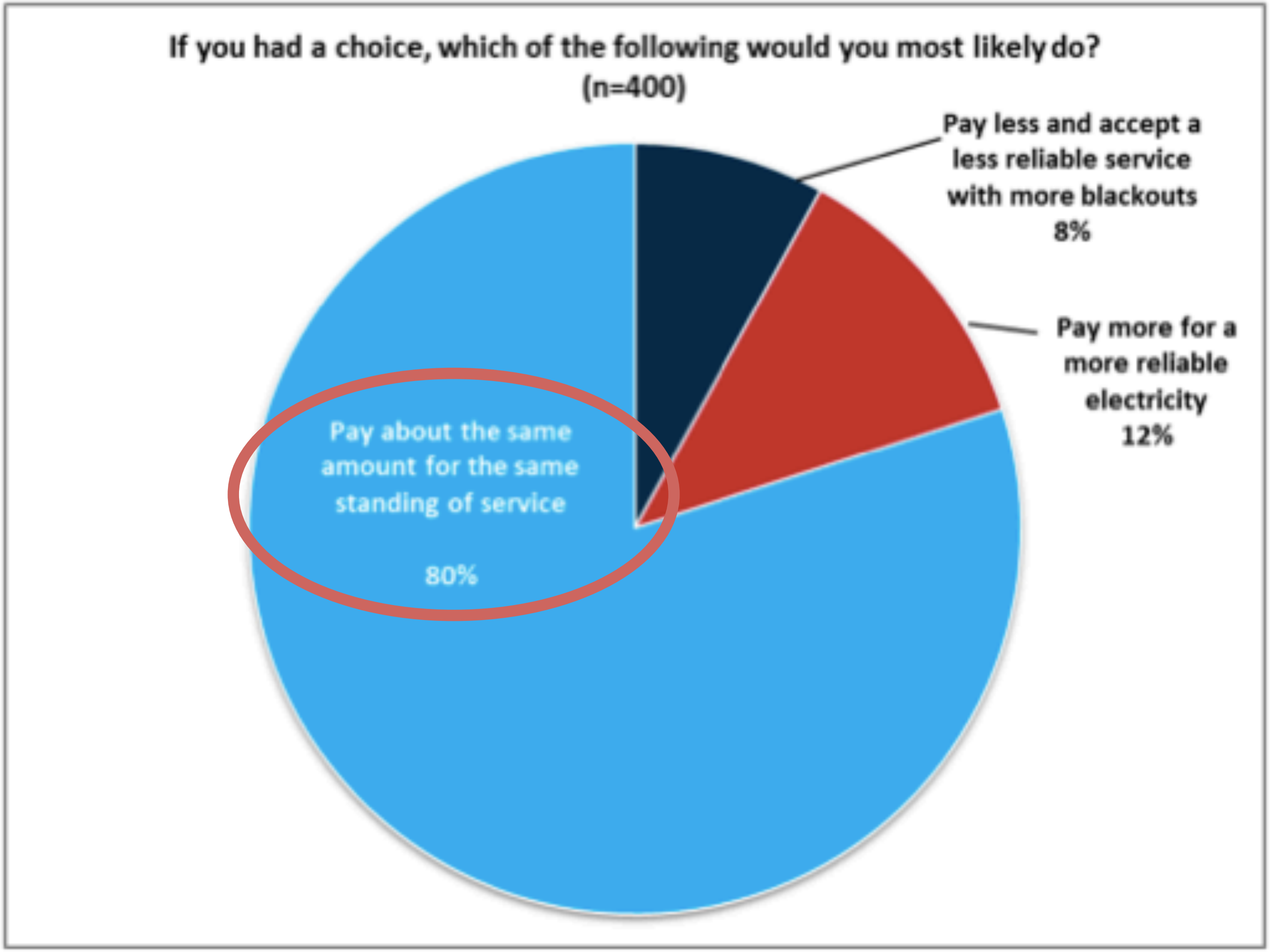
# TransGrid - Survey Question on Price/Reliability Trade-Off




Source: TransGrid Transitional Regulatory Proposal Presentation

# Transend - Survey Question on Price/Reliability Trade-Off

**Figure 3.1 Price and reliability trade-off**

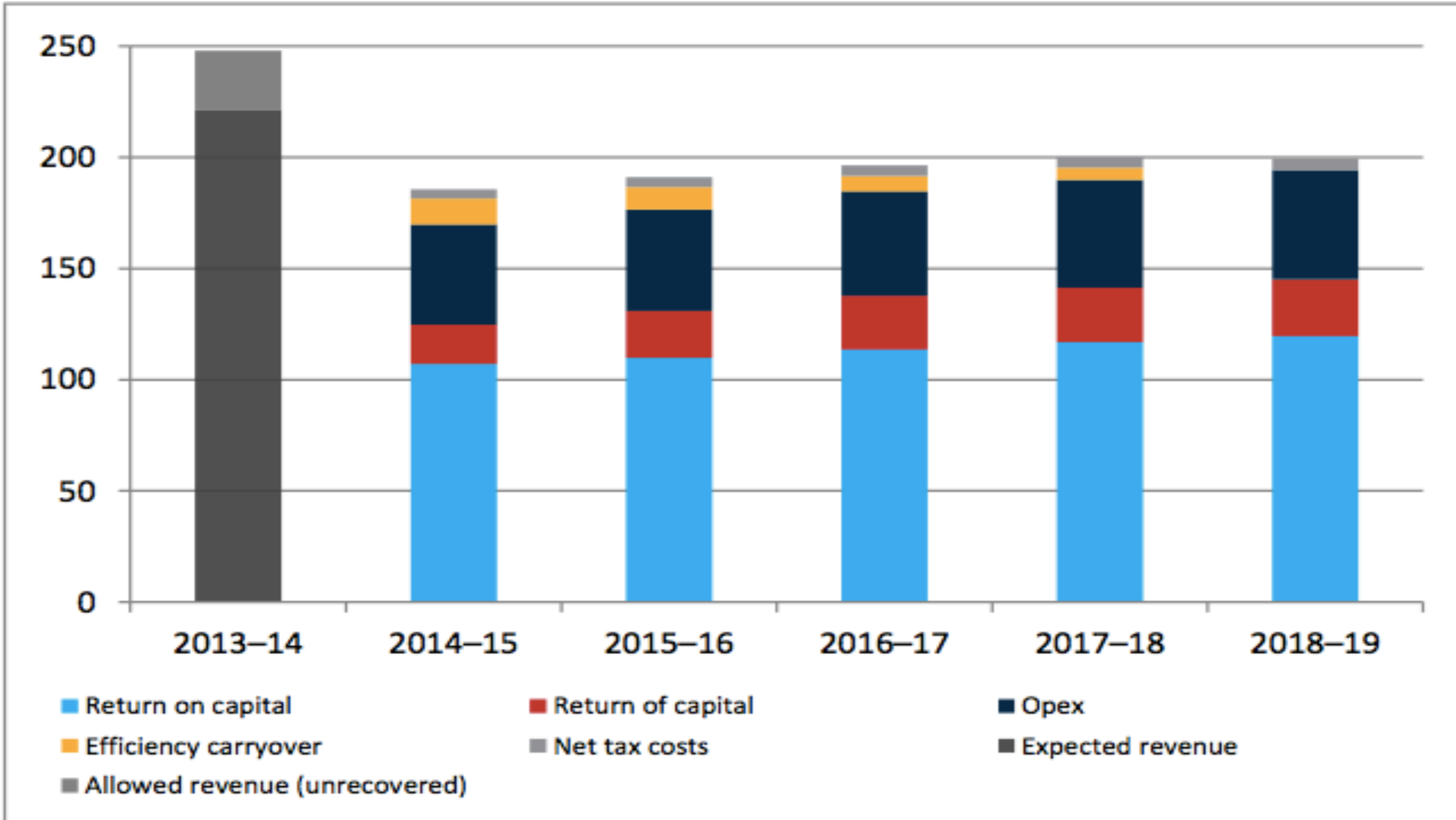


# TRANSEND

# REVENUE PROPOSAL

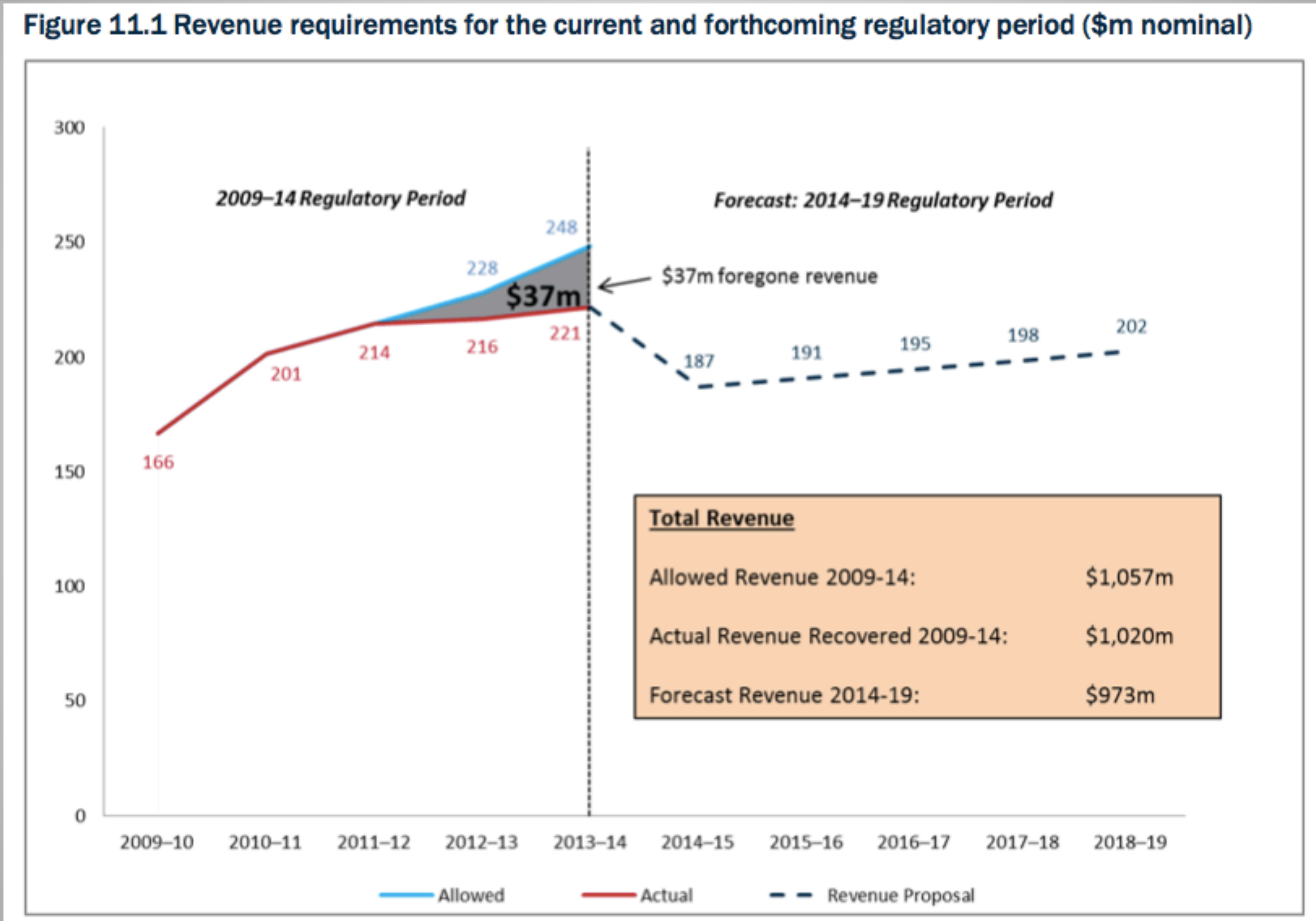
# Transend - Proposed Annual Revenue Breakdown

**Figure E.3 Annual building block revenue requirements ($m nominal)**




Source: Transend Revenue Proposal

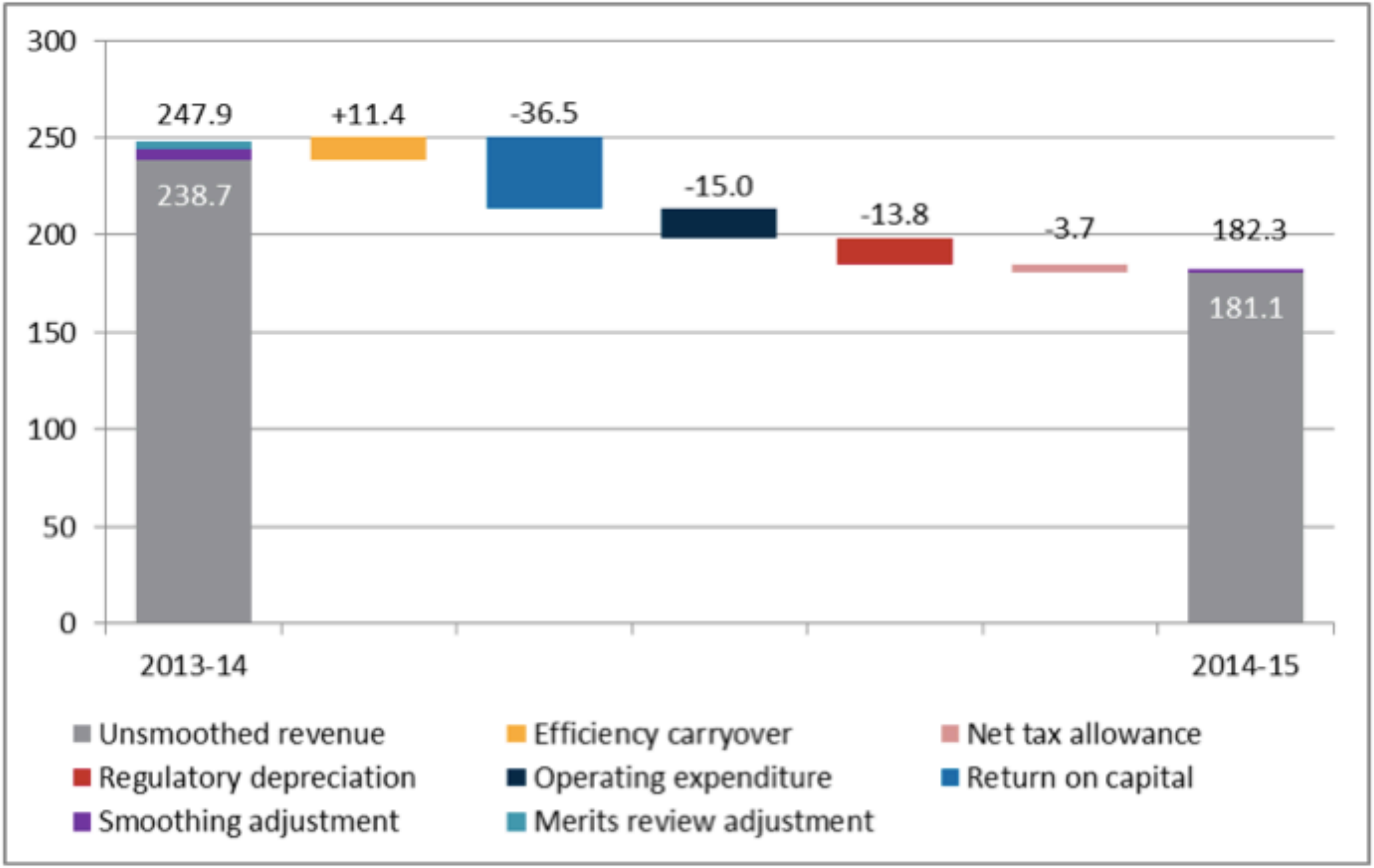
# Transend - Historical and Proposed Revenue




Source: Transend Revenue Proposal

# Key Changes in Revenue Components: 2013/14 to 2014/15

**Figure E.3 Differences between 2013–14 and 2014–15 revenues ($m 2013–14)**

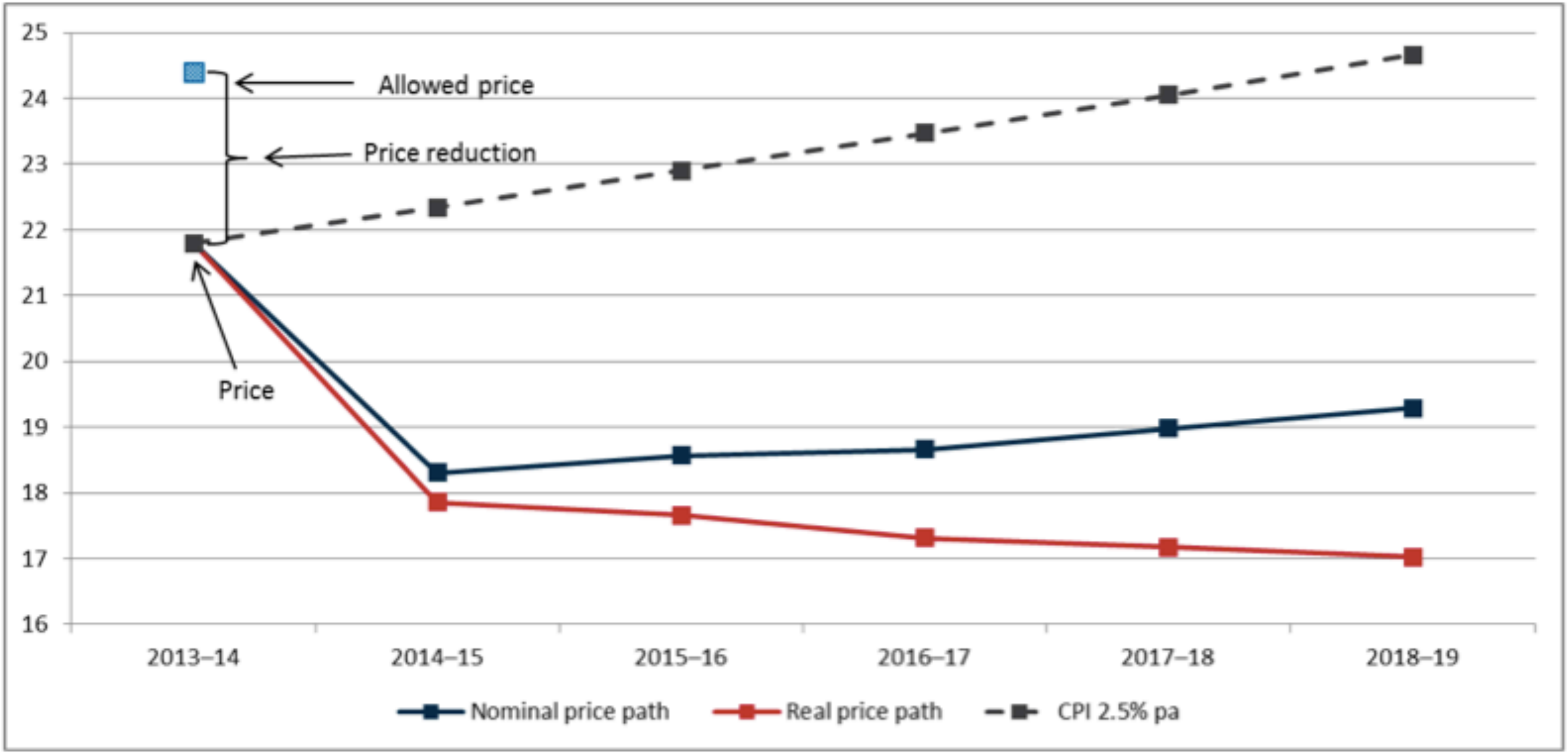



Source: Transend Revenue Proposal

# PRICE IMPACTS

# Transend - Estimated Price Impacts of Proposal

**Figure E.5 Average price impact of Revenue Proposal ($/MWh)**




Source: Transend Revenue Proposal

# Estimated Residential and Small Business Price Impacts

**Table E.3 Average annual price impact on customers ($nominal)**

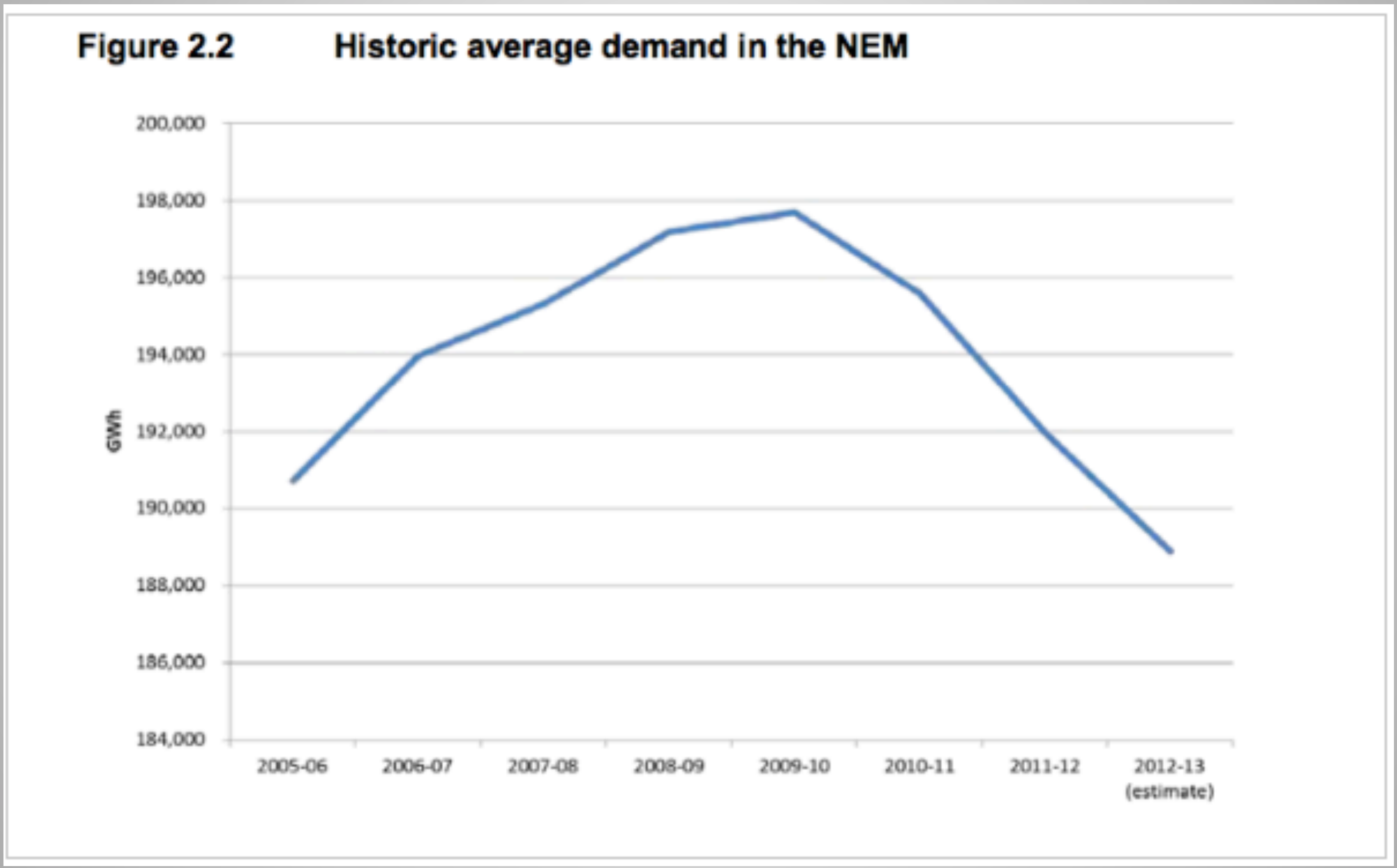
| | | Average annual charge 2013–14[1] | Impact on annual charge | | | | |
|---|---|---|---|---|---|---|---|
| | | | 2014–15 | 2015–16 | 2016–17 | 2017–18 | 2018–19 |
| Weighted average residential annual charge | Total | $2,256 | -$54 | +$4 | +$1 | +$5 | +$5 |
| | Transmission component | $338 | -$54 (-16.0%) | +$4 (+1.4%) | +$1 (+0.5%) | +$5 (+1.7%) | +$5 (+1.6%) |
| Weighted average small business annual charge | Total | $3,782 | -$91 | +$7 | +$2 | +$8 | +$8 |
| | Transmission component | $567 | -$91 (-16.0%) | +$7 (+1.4%) | +$2 (+0.5%) | +$8 (+1.7%) | +$8 (+1.6%) |

Source: Transend Revenue Proposal

# PRICE IMPACTS

# SENSITIVITY TO ENERGY DELIVERED

# Consumption Trend – National Electricity Market

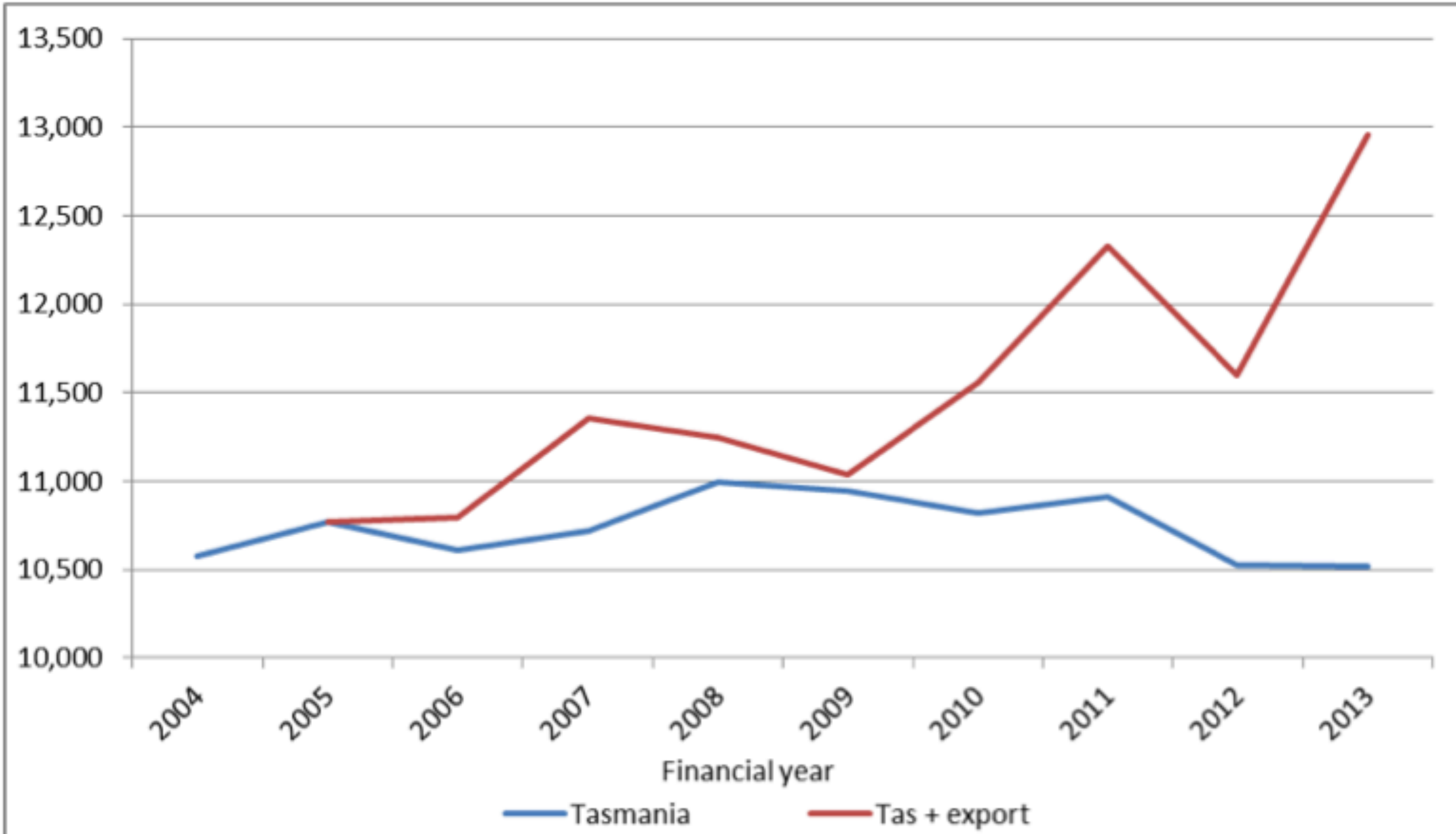


# Sensitivity of Price Impacts to Energy Delivered

- Under a *revenue cap*, Transend's revenues are fixed, irrespective of the actual energy delivered
- Transend's prices (cents/kWhr) are inversely proportional to energy consumption
- In recent regulatory determinations, the networks (and the AER) have significantly understated the price impacts due to incorrect 'energy delivered' assumptions
- Consumers expect the AER to provide a sensitivity analysis that outlines the sensitivity of the networks' prices to credible 'energy delivered' scenarios
- This should include the price impacts for different consumer groups, e.g. residential, small - medium businesses, and large consumers

# Transend - Energy Transmitted Trend

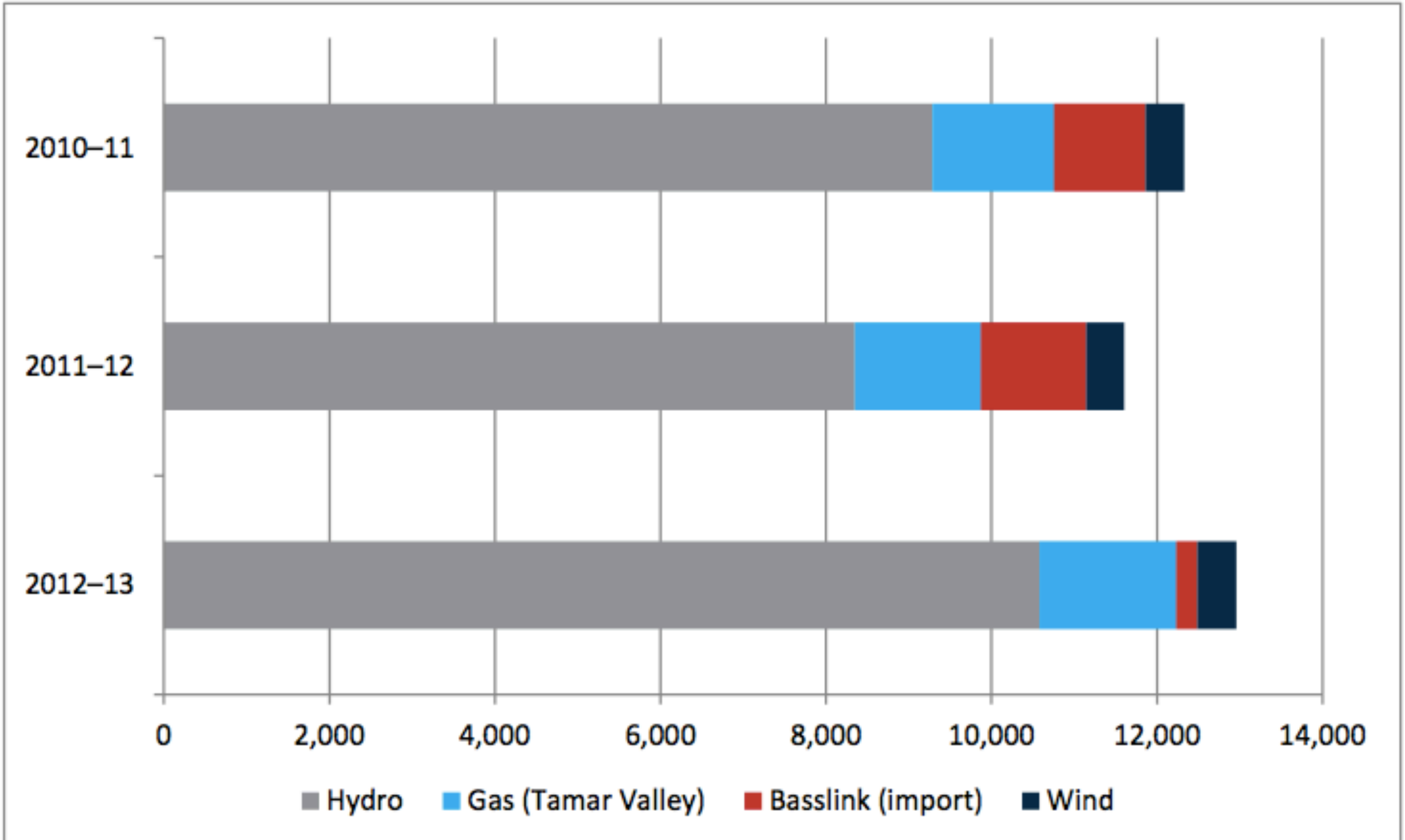
**Figure 2.6 Energy transmitted (GWh)**




Source: Transend Revenue Proposal

# Trends in Energy Transmitted by Generation Source

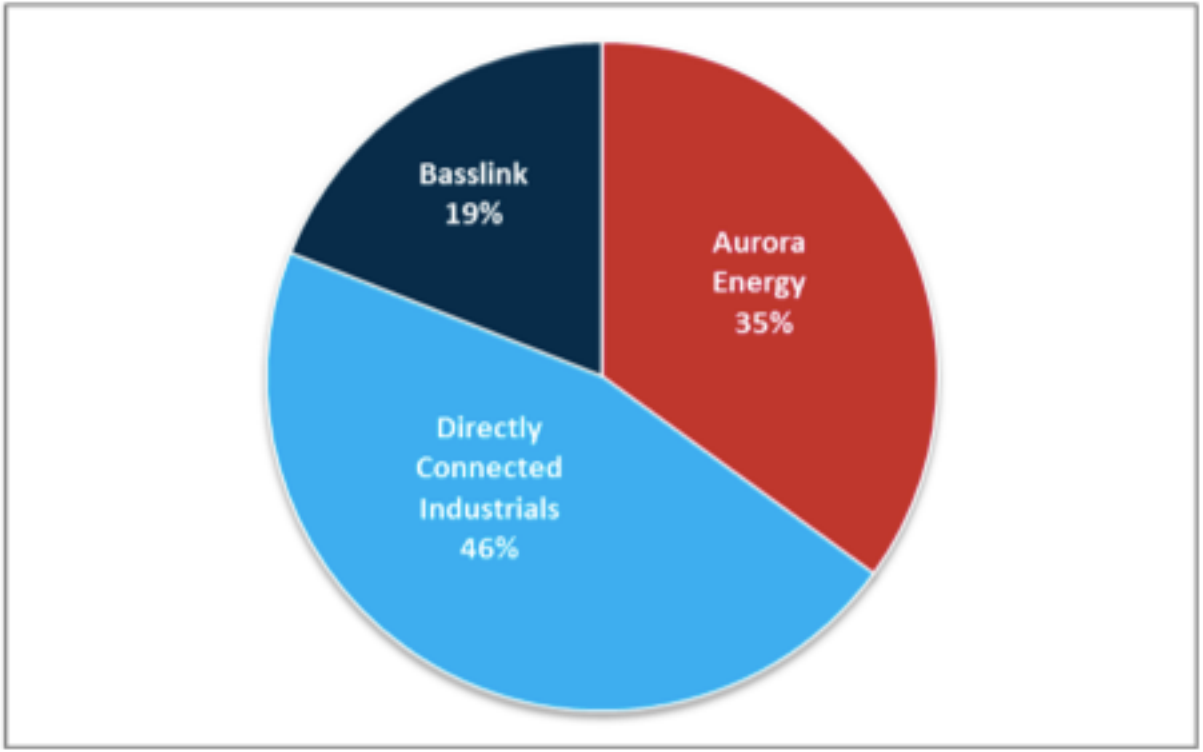
**Figure 2.4** Energy transmitted by generation source 2010–11 to 2012–13 (GWh)




Source: Transend Revenue Proposal

# Total Electricity Delivered by Customer Class

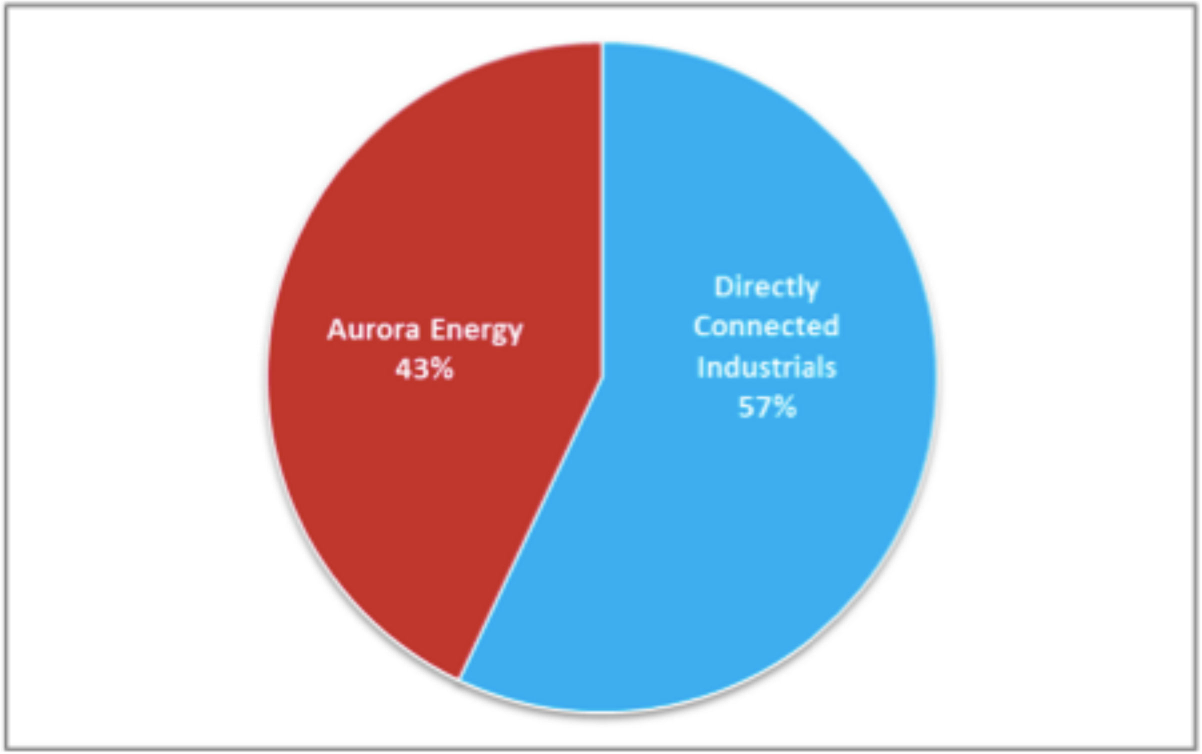
**Figure 2.2 Electricity delivered to load by customer class 2012–13**




Source: Transend Revenue Proposal

# Tasmanian Electricity Delivered by Customer Class

**Figure 2.1 Electricity delivered to Tasmanian load by customer class**




Source: Transend Revenue Proposal

# RETURN ON CAPITAL

# Return on Capital

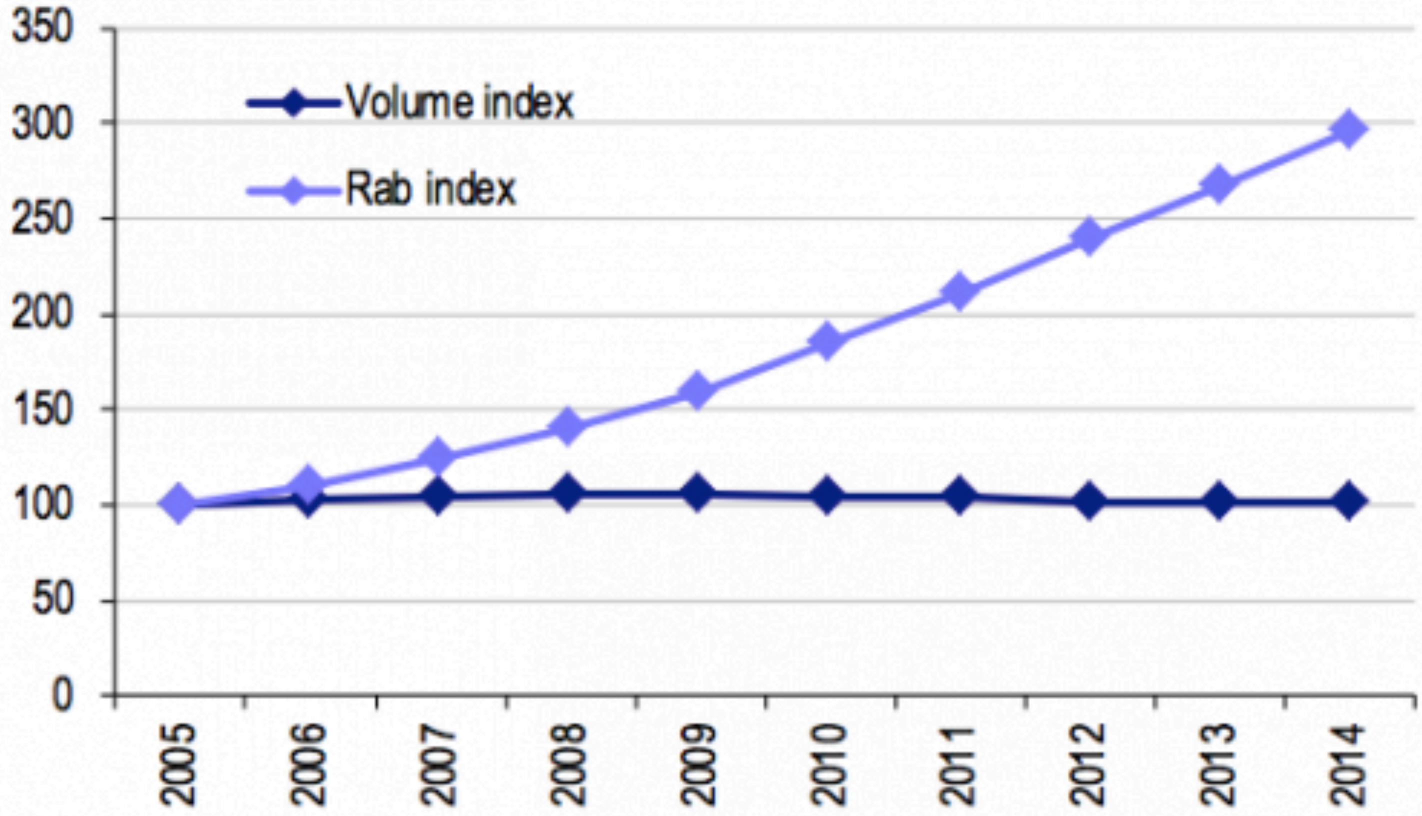
- The allowed *'return on capital'* is the return a network business requires to attract investment in the network

- Return on Capital = *Regulatory Asset Base (RAB)* x *'Rate of Return'*

- The *Regulatory Asset Base (RAB)* is the total value of all the capital investments the business makes

# Australian Electricity Networks - Recent growth in RAB

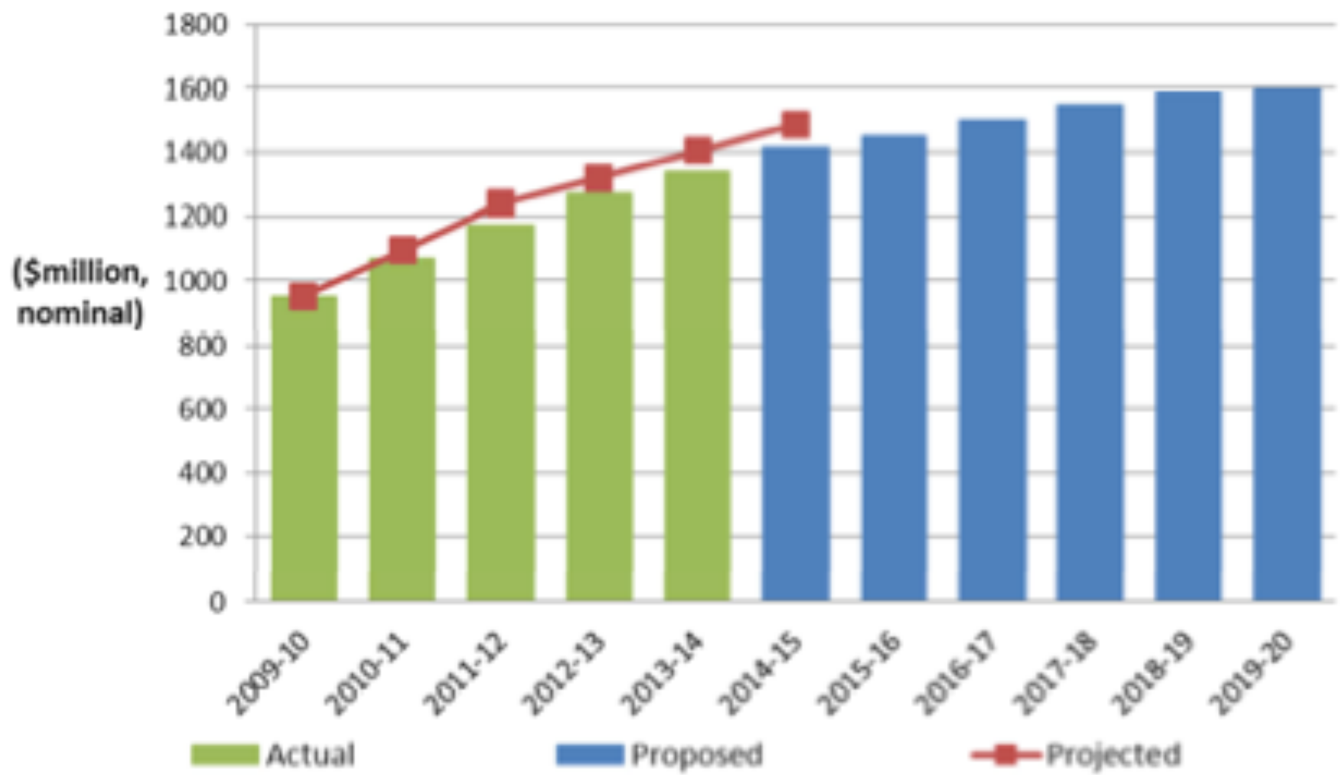
Figure 14: Australia: growth in network RAB vs. volume decline




Source: Company data, UBS estimates

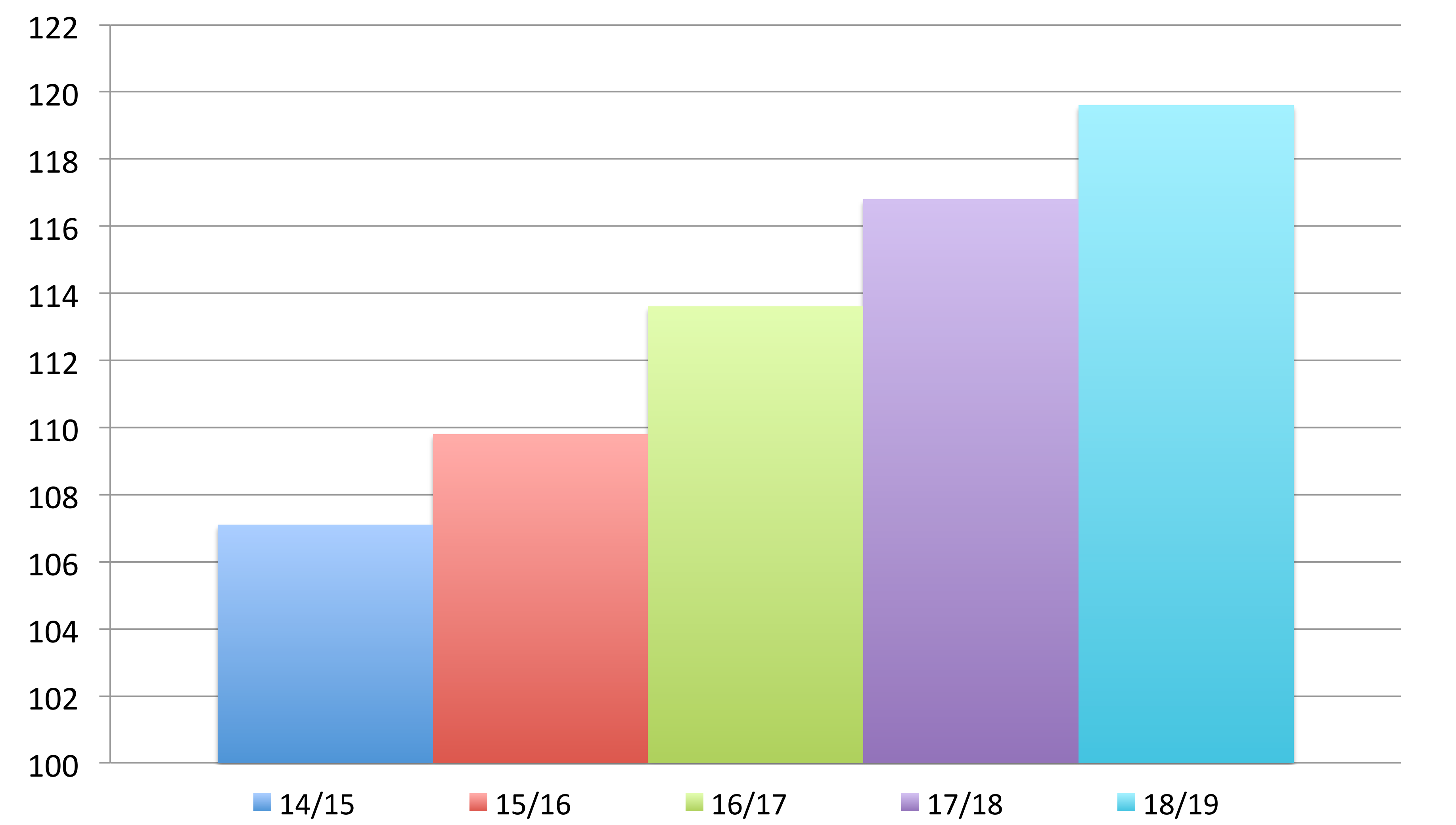
# Transend - Recent and Proposed RAB Growth

**Figure 4.5 Transend's opening RAB from 2009–19 ($m, nominal)**




Source: Transend TRP and AER analysis.

# Transend - Proposed Growth in ‘Return on Capital’




Source: Transend Revenue Proposal

# The AER's New *Rate of Return* Guideline

- The AER's *Rate of Return* guideline outlines how the AER will estimate the returns on equity and debt for the network businesses:
  - **Return on Equity** – the return shareholders require to continue to invest in the business
  - **Return on Debt** - the interest the network businesses pay when borrowing money to invest
- The AER assumes that efficient network businesses fund their investments by borrowing 60 per cent of the required funds, and raising the remaining 40 per cent from equity
- The AER's new approach to determining the Rate of Return was developed through significant consultation with a diverse range of stakeholders

# AER Rate of Return Guideline - Return on Equity

- The AER's *Rate of Return Guideline* uses a range of models, methods, and information to inform its *return on equity* estimate
- Key parameters include:
  - Returns on a risk-free asset - the **Risk Free Rate**
  - Returns to the broader market - the **Market Risk Premium (MRP)**
  - The extent to which returns on equity for network businesses vary with market conditions in general - the **Equity Beta**
- The AER determines a point estimate within a range of estimates

# AER Rate of Return Guideline - Return on Debt

- The AER's new approach is to apply the average interest rate that a network business would face if it raised debt annually in ten equal parcels - the **trailing average portfolio approach**
- It assumes that every year, one-tenth of the debt of a network business is re-financed
- The previous approach assumed that current interest rates were the best measure of the interest rates that are likely in the future
- To implement new approach, the AER guideline incorporates transitional arrangements to transition the businesses from the old to the new approach over 10 years

# WACC - Australian networks' responses to the new rules

# Networks' Proposals - Rate of Return

- The Networks are required to propose an indicative rate of return range that:
  - takes into account available market information
  - takes into account expected market trends
  - **has regard to the rate of return guidelines published by the AER**
- **Transend's <u>latest</u> revenue proposal is essentially compliant with the AER Rate of Return Guideline**
- However, other networks are proposing significant departures from the AER's rate of return guideline
- In essence, they have combined estimates from the old and new approaches in ways that result in a significantly increased WACC

# Networks' Proposals - Key Departures from the ROR Guideline

## Cost of Equity

- Significant regard to alternative models/ approaches to the guideline models/approaches

## Cost of Debt

- Proposed to immediately apply a trailing average portfolio rather than applying the 10 year transition period

# Consumers' Responses to NSPs' Proposed Departures

- Consumers have strongly objected to the Networks' proposed departures from the *Rate of Return Guideline*
- The *Rate of Return Guideline* was developed through extensive consultation over a 12 month period with a broad range of stakeholders
- By contrast, the Networks' proposed departures have not been submitted to any rigorous analysis or stakeholder consultation
- Most of the information the NSPs are using to support their departures was already considered by the AER during the development of the ROR guideline

# RATE OF RETURN

## THE AER'S INITIAL APPLICATION OF THE NEW RULES

# WACC Determinations - The AER's obligations Under the New Rules

- The new rule require the AER to:
  - Consider a range of factors when determining the allowed rate of return, **including relevant estimation methods, financial models, market data and other evidence**
  - Exercise its discretion in estimating the rate of return, by **adopting the approach it considers most appropriate** to achieve WACC outcomes in the long-term interests of consumers

*"The amendments made **will provide the Australian Energy Regulator (AER) with additional strength and flexibility** in setting revenues and prices for electricity and gas network service providers"*

*"The Commission has provided high-level principles to guide the estimation **and left the judgement as to the best approach to the regulator to make**, consistent with achieving the overall allowed rate of return objective"*

Source: AEMC Determination - National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012

# WACC - AER's Transitional Decision

| WACC Component | Transend Transitional Proposal | AER Transitional Decision |
|---|---|---|
| **Cost of Equity** | | |
| Risk Free Rate | 4.06% | 4.3% |
| Market Risk Premium | 6.5% | 6.5% |
| Equity Beta | 0.91 | 0.7 |
| **Total Cost of Equity** | **9.98%** | **8.9%** |
| **Cost of Debt** | **7.4%** | **7.5%** |
| **Total WACC** | **8.43%** | **8.1%** |

Sources: Transend Revenue Proposals and AER Transitional Decision

# WACC - New Rules compared to old Rules

| WACC Component | AER Decision on SP AusNet (Jan 2014) | AER Transitional Decisions | Difference |
|---|---|---|---|
| **Cost of Equity** | | | |
| Risk Free Rate | 4.31% | 4.3% | - 0.01% |
| Market Risk Premium | 6.5% | 6.5% | - |
| Equity Beta | 0.8 | 0.7 | - 0.1 |
| **Total Cost of Equity** | **9.51%** | **8.9%** | **- 0.61%** |
| **Cost of Debt** | **6.79%** | **7.5%** | **+ 0.71%** |
| **Total WACC** | **7.87%** | **8.1%** | **+ 0.23%** |

Sources: AER Regulatory Determination for SP AusNet, AER Transitional Decisions

# The AER's Initial Application of the new Rules

- Consumers are concerned that the AER has inappropriately applied its discretion by selecting the highest value in the WACC range

- This is in addition to a number of the input parameters in the *AER Rate of Return Guideline* having already been selected at the top of the possible ranges e.g:
  - For the 'equity beta' range of 0.4 to 0.7 - the AER has adopted 0.7

- Consumers expect the AER to exercise its discretion in a more balanced manner

# Comparisons with WACC Decisions of Other Regulators

- Over the past decade, consumers have repeatedly expressed concerns regarding the AER's WACC determinations being higher than the determinations of other regulators in Australia and overseas

- Comparisons with Australian Regulators
  - The AER has consistently set higher WACCs compared to the determinations of the ACCC and state regulators

- Comparisons with International Regulators
  - The AER has consistently set higher WACCs compared to equivalent international regulators
  - For example, The UK regulator (Ofgem) recently outlined a 2015/16 WACC of 3.8% for five UK distribution entities, with further falls in the WACC projected in subsequent years

# Rate of Return - Relevant Market Information

- The new rules require the AER to consider "market data and other evidence" when making its 'rate of return' determinations

- There is growing evidence that investors are paying substantial premiums above the Regulated Asset Base (RAB) when investing in Australian energy networks, e.g:
  - CKI's recent purchase of a stake in DUET has an implied RAB multiple of 128%
  - The current offer by CKI for Envestra has an implied RAB multiple of over 150%

- The networks' profitability growth trends indicate that the industry is significantly more profitable than the regulatory framework assumes

- Consumers expect the AER to take account of this 'market information' when making its WACC determinations

# WACC - Transend's Transitional and Full Revenue Proposals

| WACC Component | Transend Transitional Proposal | AER Transitional Decision | Transend Full Revenue Proposal |
|---|---|---|---|
| **Cost of Equity** | | | |
| Risk Free Rate | 4.06% | 4.3% | 4.11% |
| Market Risk Premium | 6.5% | 6.5% | 6.5% |
| Equity Beta | 0.91 | 0.7 | 0.7% |
| **Total Cost of Equity** | **9.98%** | **8.9%** | **8.7%** |
| **Cost of Debt** | **7.4%** | **7.5%** | **6.84%** |
| **Total WACC** | **8.43%** | **8.1%** | **7.58%** |

Sources: Transend Revenue Proposals and AER Transitional Decision

# CAPEX

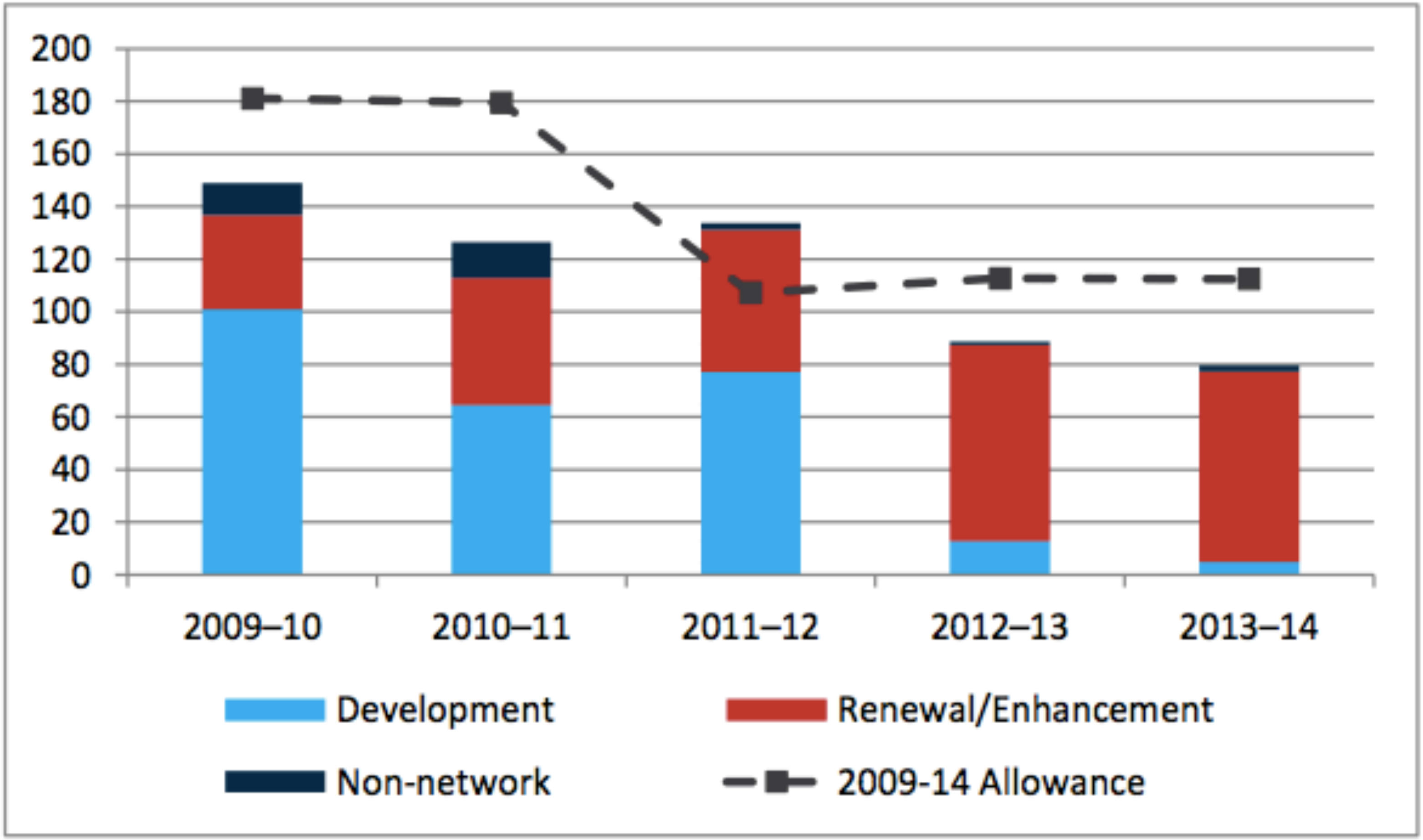
# Transend - Capex During Current Period

**Table 4.1 Allowed and actual capital expenditure by category ($m 2013–14)**

| Category | 2009–14 Allowance | Historical expenditure 2009–14 | Variance |
|---|---|---|---|
| Augmentation | 242.1 | 190.5 | -51.5 |
| Connection | 126.0 | 68.9 | -57.1 |
| Land and easements | 24.1 | 0.6 | -23.5 |
| **Development capex** | **392.2** | **260.1** | **-132.1** |
| Asset renewal/enhancement | 203.7 | 245.2 | 41.6 |
| Physical security/compliance | 22.1 | 14.4 | -7.7 |
| Inventory/spares | 12.1 | 9.9 | -2.3 |
| Operational support systems | 23.9 | 15.9 | -8.0 |
| **Renewal/enhancement capex** | **261.7** | **285.4** | **23.7** |
| Information technology | 19.1 | 6.4 | -12.7 |
| Business support | 19.5 | 25.3 | 5.8 |
| **Support the business capex** | **38.6** | **31.7** | **-6.9** |
| **Total** | **692.5** | **577.2** | **-115.3** |

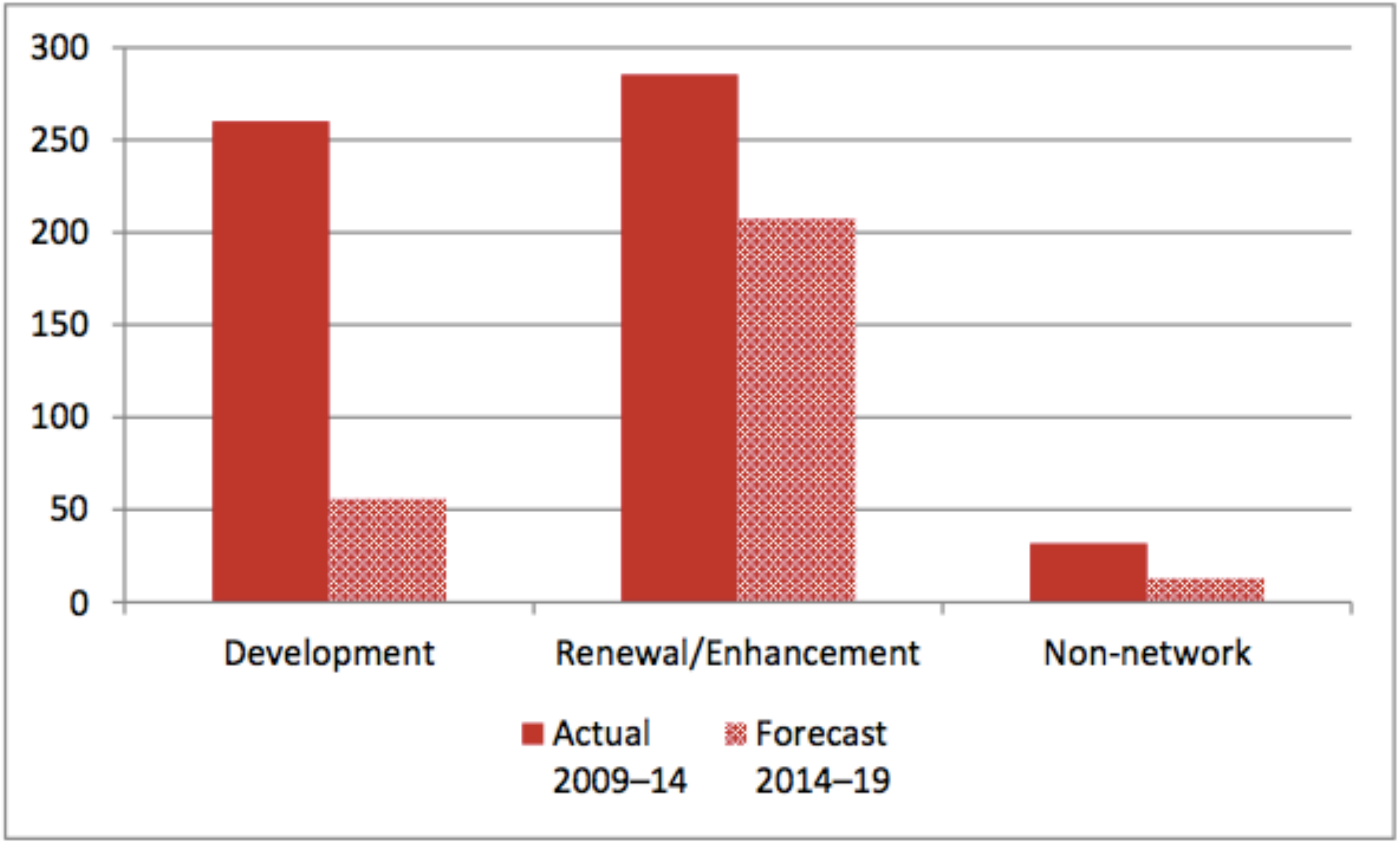
# Capex Breakdown During Current Period

Figure 4.1 Capital expenditure ($m 2013–14)



# Capex Breakdown - Previous and New Regulatory Periods

**Figure 5.5 Comparison of past and forecast capital expenditure by major category ($m 2013–14)**



# Augmentation Capex

- The load forecasts for the next regulatory period are lower than the forecasts used to justify augmentation capex during the current period
- Consequently, minimal augmentation capex should be anticipated for the next regulatory period

# Replacement Capex

- It appears that Transend overspent its replacement capex allowance by around 20% during the current regulatory period
- By overspending on this replacement capex, Transend has effectively ‘pre-installed’ some replacement capex for the next regulatory period
- Premature replacement of assets on the basis of age, rather than asset condition, is a key driver of unnecessary network expenditure and unnecessary price increases
- Consumers expect the AER to apply a high degree of scrutiny to all networks’ proposed replacement capex

# Standard Asset Lives?

**Table 9.1 Standard asset lives**

| Asset class | Standard life (years) |
| --- | --- |
| Transmission line assets—long life (60) | 60 |
| Transmission line assets—medium life (45) | 45 |
| Transmission line assets—short life (10) | 10 |
| Substation assets—long life (60) | 60 |
| Substation assets—medium life (45) | 45 |
| Substation assets—short life (15) | 15 |
| Protection and control—short life (15) | 15 |
| Protection and control—very short life (4) | 4 |
| Transmission operations—short life (10) | 10 |
| Transmission operations—very short life (4) | 4 |
| Communication assets—medium life (45) | 45 |
| Communication assets—short life (10) | 10 |
| Communication assets—very short life (5) | 5 |
| Other—medium life (40) | 40 |
| Other—short life (9) | 9 |
| Other—very short life (4) | 4 |
| Land | N/A |

Source: Transend Revenue Proposal

**Asset Categories and Standard Lives**

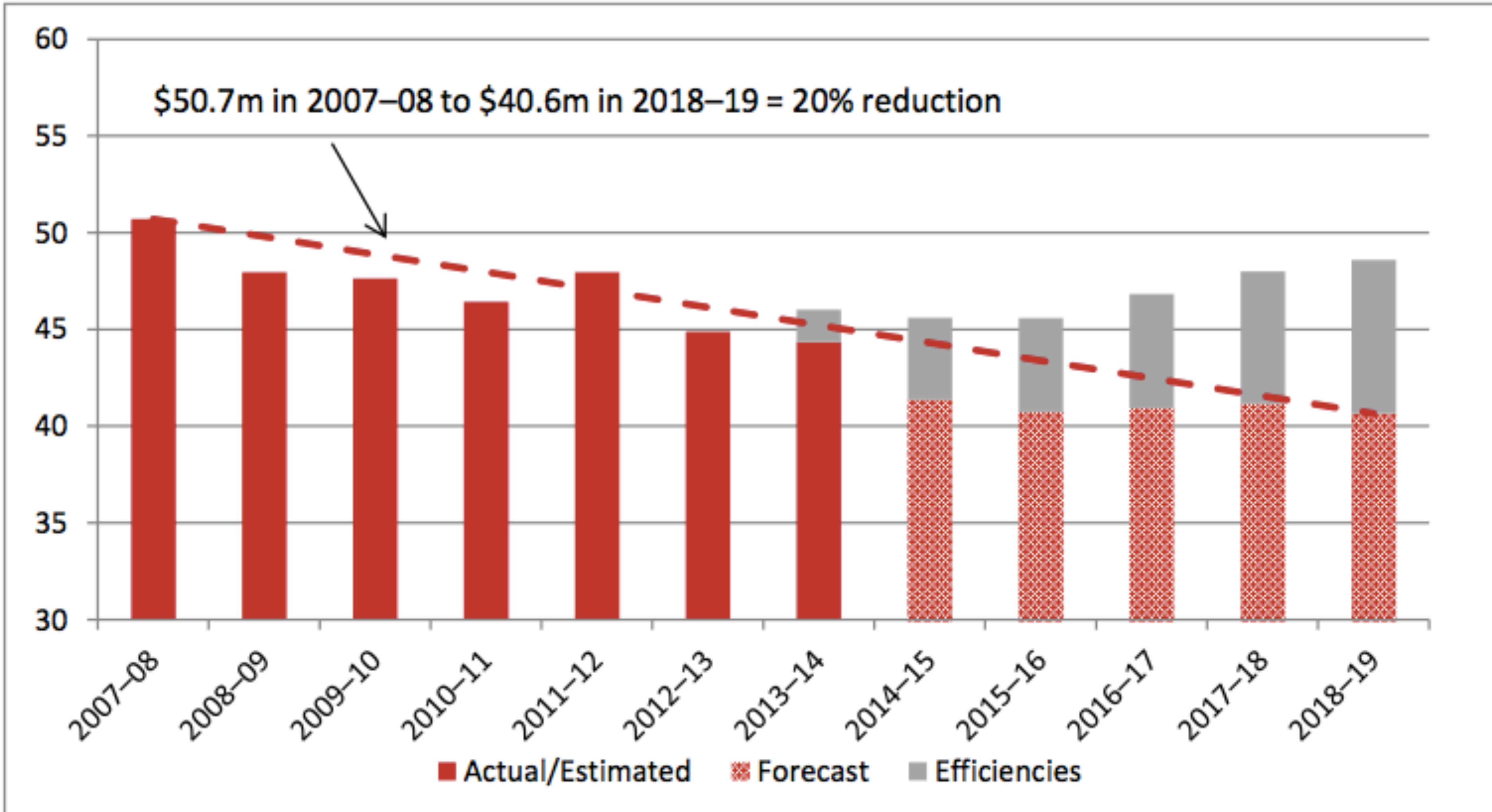
| No | Asset Class | Asset Life (Years) |
| --- | --- | --- |
| 1 | Transmission Lines (2014-18) | 50 |
| 2 | Underground Cables (2014-18) | 45 |
| 3 | Substations (2014-18) | 40 |
| 4 | Secondary Systems (2014-18) | 15 |
| 5 | Communications (2014-18) | 10 |
| 6 | Business IT (2014-18) | 4 |
| 7 | Minor Plant, Motor Vehicles and Mobile Plant (2014-18) | 8 |
| 8 | Transmission Line Life Extension (2014-18) | 25 |
| 9 | Land and Easements | N/A |

Source: TransGrid Revenue Proposal

# OPEX

# Transend - Controllable Opex Trend

**Figure 6.5 Controllable operating expenditure 2007–08 to 2018–19 ($m 2013–14)**




Source: Transend Revenue Proposal

# Transend - Proposed Step Changes

**Table 6.2 Forecast step changes and add to base costs ($m 2013–14)**

| Item | 2013–14 | 2014–15 | 2015–16 | 2016–17 | 2017–18 | 2018–19 | Total 2014–19 |
|---|---|---|---|---|---|---|---|
| AEMO operating agreement | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 1.9 |
| Better Regulation program | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 2.1 |
| **Total step changes** | **0.8** | **0.8** | **0.8** | **0.8** | **0.8** | **0.8** | **4.0** |

Source: Transend Revenue Proposal

# Labour Cost Escalation

- Transend claims its labour costs will increase at rates above CPI:

**Table 6.5 Escalation factors for labour cost inputs (per cent real)**

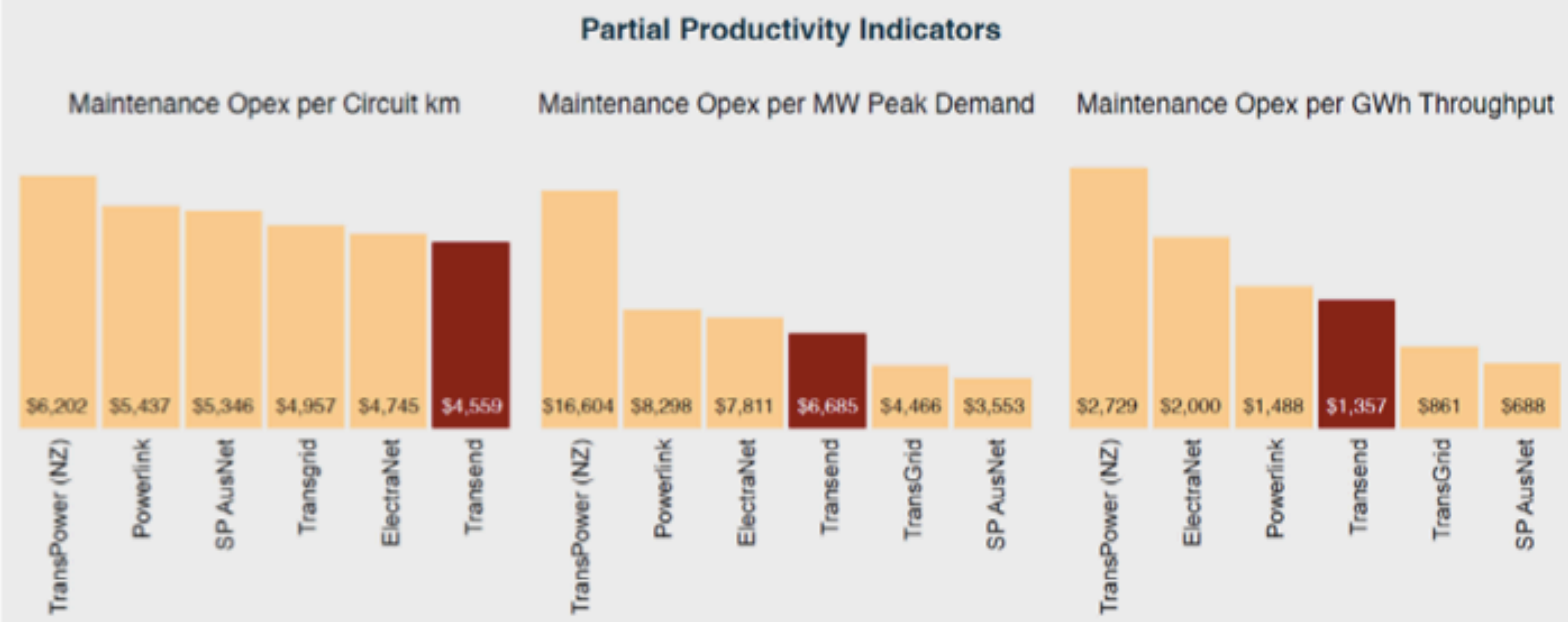
| Input | 2013-14 | 2014–15 | 2015–16 | 2016–17 | 2017–18 | 2018–19 |
|---|---|---|---|---|---|---|
| Tas utilities labour | 0.2 | -0.3 | 1.1 | 2.0 | 2.0 | 2.0 |

Source: Transend Revenue Proposal

- How can an industry that is in contraction due to declining demand for its product, credibly claim labour cost pressures in excess of CPI?

# Productivity Indicators

**Figure 4.5 Partial productivity indicator - Field operations and maintenance**




With Transend's small scale, small peak demand and low throughput, maintenance costs as a ratio of these variables is expected to be at the higher end of the group; however the data shows the opposite. Despite the disadvantages of scale,Transend achieves relatively lower maintenance costs than most of its peers.

Source: Huegin, Transmission Benchmarking Study 2013: Report for Transend, March 2014, page 30.

# Australian TNSPs - Opex/RAB Trends

**Figure 4.4** **Ratio of prescribed opex to regulated asset base value**

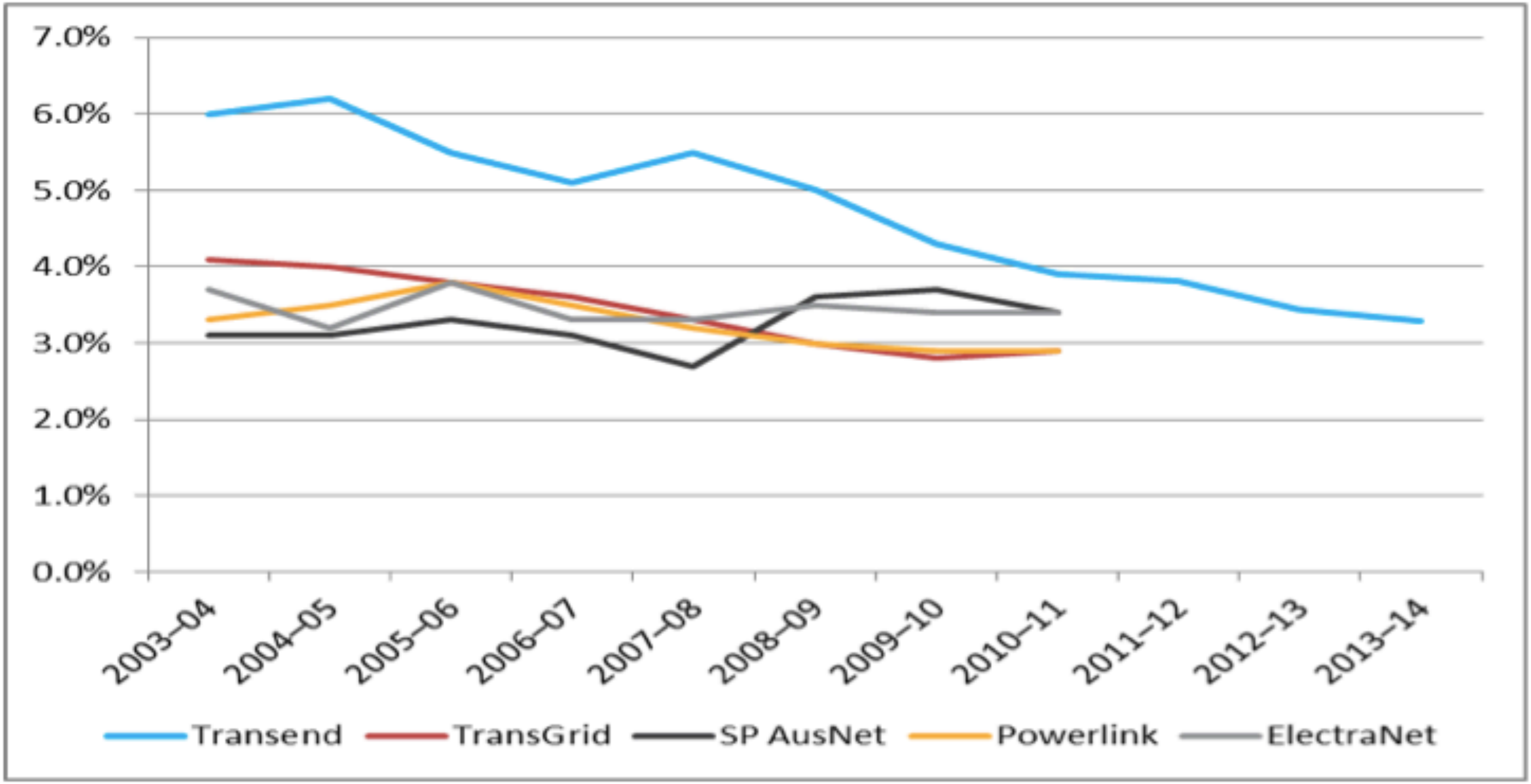
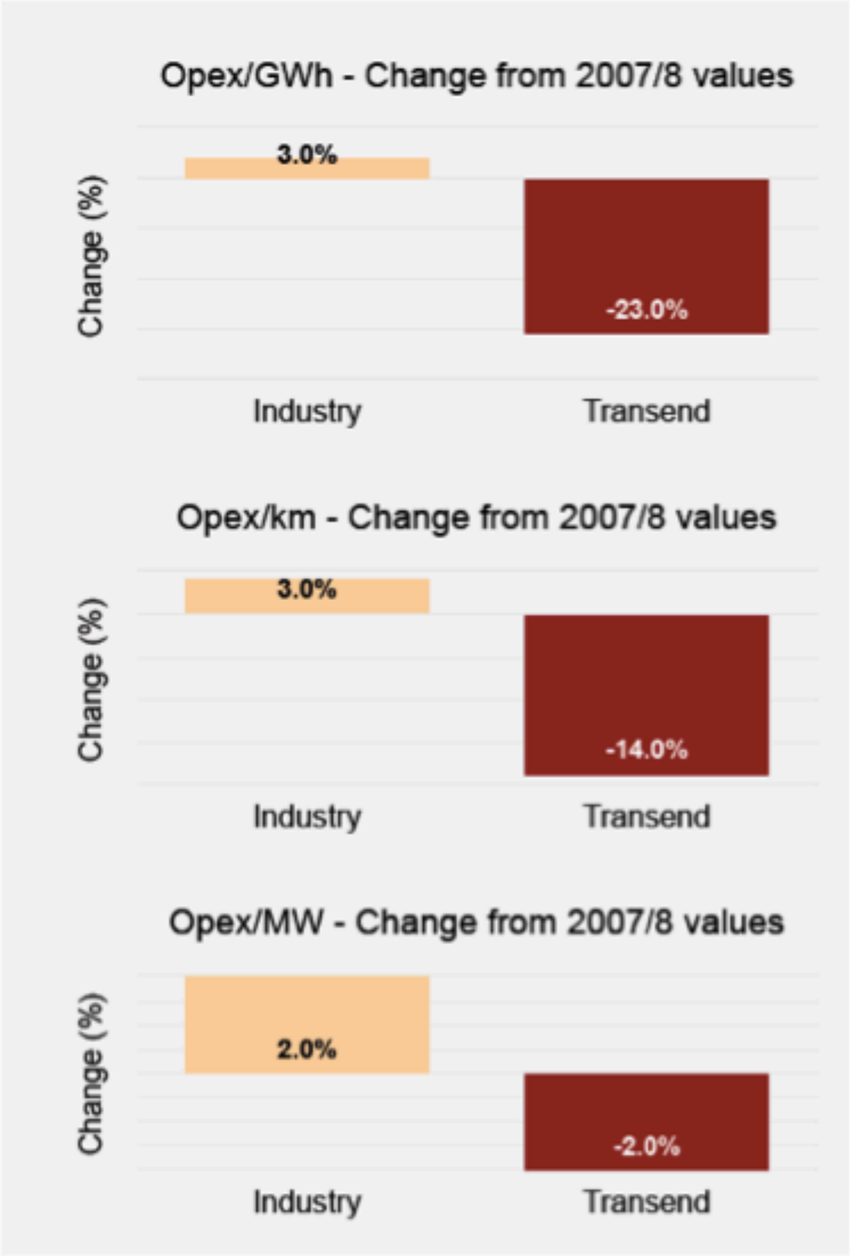


**Figure 6.4 Change in operating expenditure measures since 2007–08**




Source: Huegin, Transend Base Year Operating Expenditure Efficiency- Transend, 21 February 2014, page 16.

# Transend - Estimated Opex Efficiency Improvements

**Table 6.6 Efficiency improvements ($m 2013–14)**

| Item | 2013-14 | 2014–15 | 2015–16 | 2016–17 | 2017–18 | 2018–19 |
|---|---|---|---|---|---|---|
| Annual efficiency | 1.7 | 2.6 | 0.6 | 1.0 | 1.0 | 1.1 |
| Cumulative efficiency | 1.7 | 4.2 | 4.8 | 5.9 | 6.9 | 7.9 |

# PERFORMANCE INCENTIVE SCHEMES

# Performance incentive schemes

- Efficiency Benefit Sharing Scheme (EBSS)
- Service Target Performance Incentive Scheme (STPIS)
- Demand Management Incentive Scheme (DMIS)
- Capital Expenditure Sharing Scheme (CESS)
- Network Capability Incentive Parameter Action Plan (NCIPAP)

# Efficiency Benefit Sharing Scheme (EBSS) – Transend Bonuses

**Table 7.2 Efficiency carryover ($m 2013–14)**

| | 2009–10 | 2010–11 | 2011–12 | 2012–13 | 2013–14 |
|---|---|---|---|---|---|
| Efficiency carryover | 11.4 | 9.6 | 6.4 | 5.0 | 0.0 |

Source: Transend Revenue Proposal

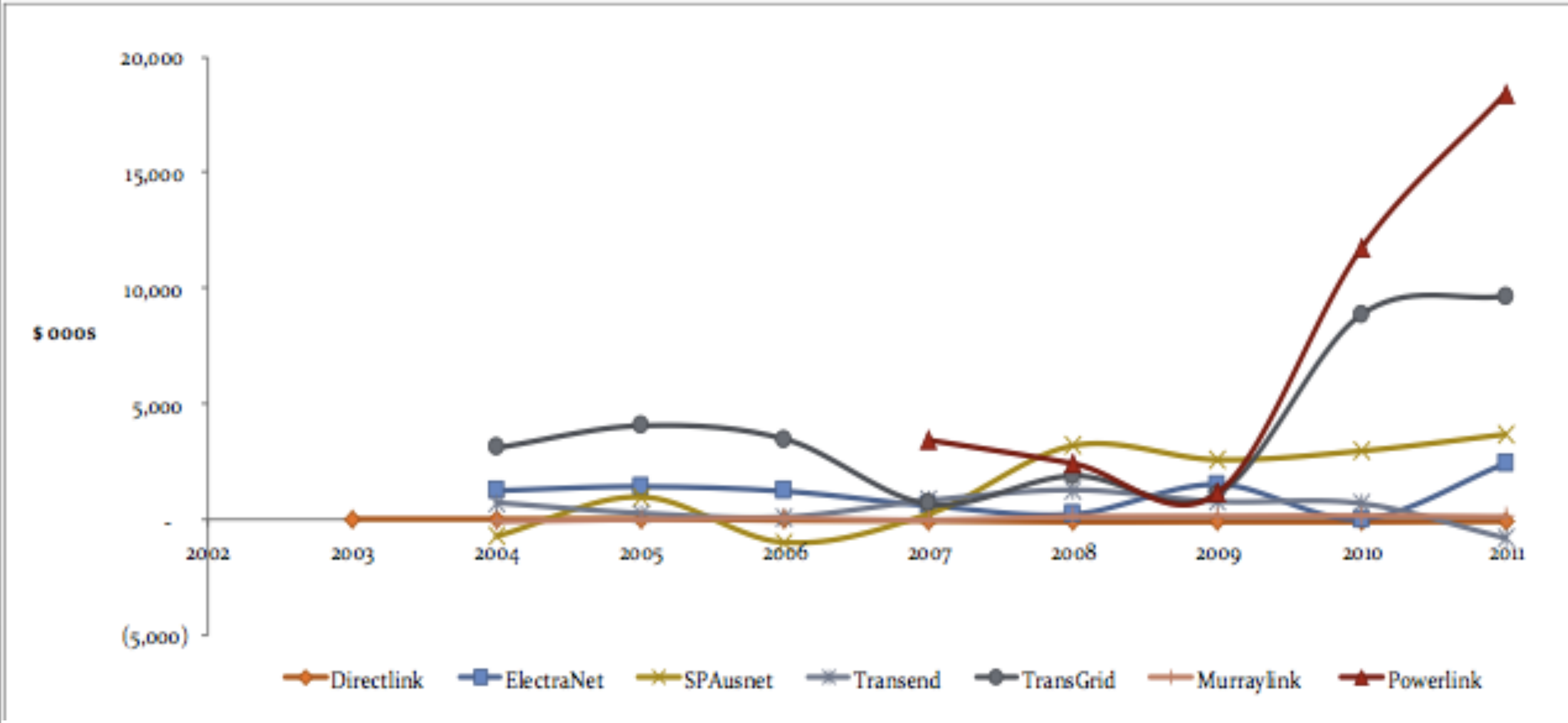
# Transend - STPIS Scheme Outcomes

**Table 4.7 Service target performance incentive scheme outcomes**

| Parameter | Weighting % MAR | S-factors (%MAR) | | | | |
|---|---|---|---|---|---|---|
| | | 2009 (6 mths) | 2010 | 2011 | 2012 | 2013 |
| *Circuit availability* | | | | | | |
| Transmission lines (critical) | ±0.20 | 0.20 | 0.11 | -0.13 | 0.18 | 0.09 |
| Transmission lines (non-critical) | ±0.10 | 0.06 | 0.08 | 0.01 | 0.09 | 0.09 |
| Transformers | ±0.15 | 0.00 | -0.04 | -0.08 | -0.10 | 0.05 |
| *Loss of supply events* | | | | | | |
| Loss-of-supply > 0.1 system minute | ±0.20 | 0.20 | 0.20 | 0.13 | 0.17 | 0.17 |
| Loss-of-supply > 1.0 system minute | ±0.35 | -0.35 | 0.00 | -0.35 | 0.00 | 0.18 |
| *Average outage duration* | | | | | | |
| Average outage duration (transmission lines) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Average outage duration (transformers) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| **Total** | ±1.00 | **0.11** | **0.35** | **-0.41** | **0.33** | **0.57** |

# Incentive Schemes - Reliability

**Figure 9.1 Financial incentives in $2011 million**




Source: AER TNSP Performance Report 2009/10

# STRANDED ASSETS?

# Death Spiral?

*"It could be inevitable that all forms of centralised generation and transmission will be made redundant over time"*

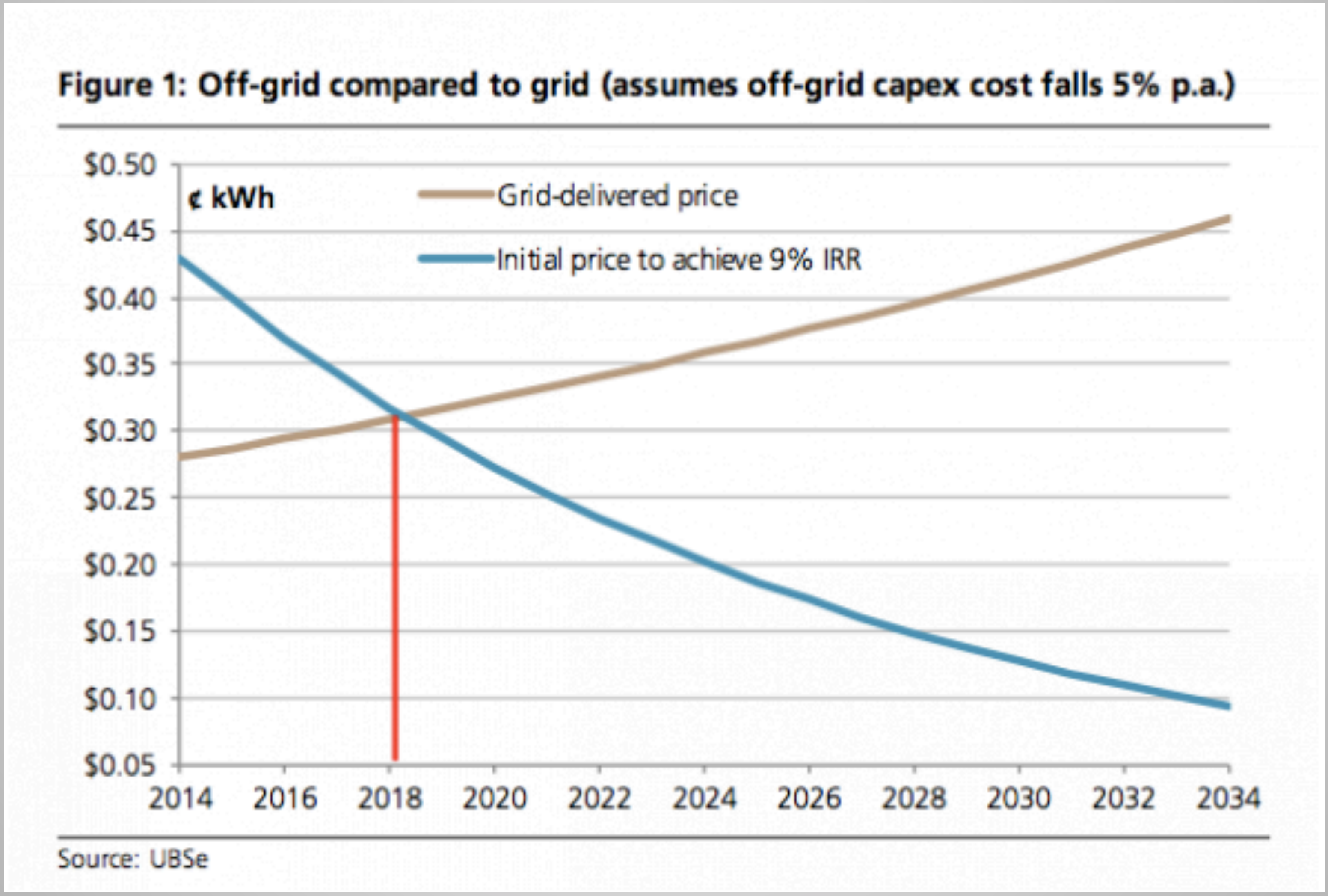
Rob Stobbe, CEO - SA Power Networks

*"Will we see a time in the next decade where renewables and battery storage will be cheaper than grid power for the domestic consumer?"*

Malcolm Hall-Brown, Chairman - Ergon Energy

Sources:
- Giles Parkinson article: "SA network operator: Rural communities could quit the grid", 30 April 2014
- Ergon Energy 2012/13 Annual Stakeholder Report, Chairman's Message

# Distributed Generation - Economics



# Stranded Asset Risks

- Most networks' proposals have ignored the "elephant in the room" - the decreasing energy delivered by the networks and the associated risks of stranded, or significantly devalued, assets
- For example, TransGrid's proposal suggests that if any assets become stranded, they would easily be relocated or recycled
- This is clearly not a credible response to this critical issue
- Consumers expect the AER to seriously challenge the networks on their approaches managing this critical issue

# Concluding Comments

- The AER will determine the future revenues of 17 Australian electricity networks over the next 2 years, using the new regulatory rules
- The Transend determination provides the opportunity for consumers to outline how they expect the new rules to be applied
- Consumers' involvement will be critical in influencing the AER to make regulatory decisions ***"in the long term interest of consumers"***

# Thank You

**AER Public Forum - 9th July 2014**

**Hugh Grant - Executive Director, *ResponseAbility***