EnergyAustralia Application for Revenue Cap – ACCC Draft Decision

A Presentation for the ACCC Forum
18 June 2004

By

The Energy Markets Reform Forum
David Headberry, Consultant to EMRF

The EMRF and its views

- Energy Markets Reform Forum (EMRF) comprises major electricity users in NSW – OneSteel, BHP Billiton, BlueScope Steel, Hydro Aluminium Kurri Kurri, Visy Paper, Orica, Tomago Aluminium and AMCOR
- EMRF lodged 3 submissions, inter alia, expressing concerns with EA's application
  - The very substantial increase in revenues for 2004/05 (55.7% nominal increase over current regulatory allowance)
  - Their surprising attitude to the need to provide justification and transparency for
    - the large capex claims (past over-runs and projected)
    - the large opex claims (past over-runs and projected)
- EMRF supports the ACCC and its consultants (GHD) for rejecting any cost claims that are not supported by data to establish they are prudent and economically efficient

EMRF

Information disclosure

- ***"GHD have concluded that EnergyAustralia do not collect the information useful and necessary to undertake a regulatory review to meet the requirements …"*** (GHD report page 53)
- **GHD had to interpret and recast information to draw conclusions fundamental to assessing EA RAB, past capex and past opex**
- **The ACCC draft decision does provide some of the missing information to assist consumer input to the review**
- **Notwithstanding its further examination the ACCC has been unable to be satisfied about future capex claims.**
- **The ACCC has not provided any disciplinary action on EA for not providing adequate information and has rushed through a draft decision based on insufficient data, providing EA an initial over-recovery in revenue.**

EMRF

The historic capex to be included in the RAB

- GHD was unable to recommend a level for past capex
- In its responses to the application and the consultant report, the EMRF consistently commented that EA had not provided adequate documentation to prove all its past capex is prudent
- It is welcome that the ACCC draft decision supports this view and as a result discounts the claimed capex by some $62m seen as not prudent
- EMRF disagrees with including foregone rate of return on the capital overspend – this is inconsistent with the IPART approach in the distribution review of EA
- It is disappointing that after all the discussions and debate about investments needing to be prudent, that EA could not provide an adequate written history demonstrating all its capex was and remains prudent
- It is surprising that EA uses ignorance as a defence for not providing necessary information

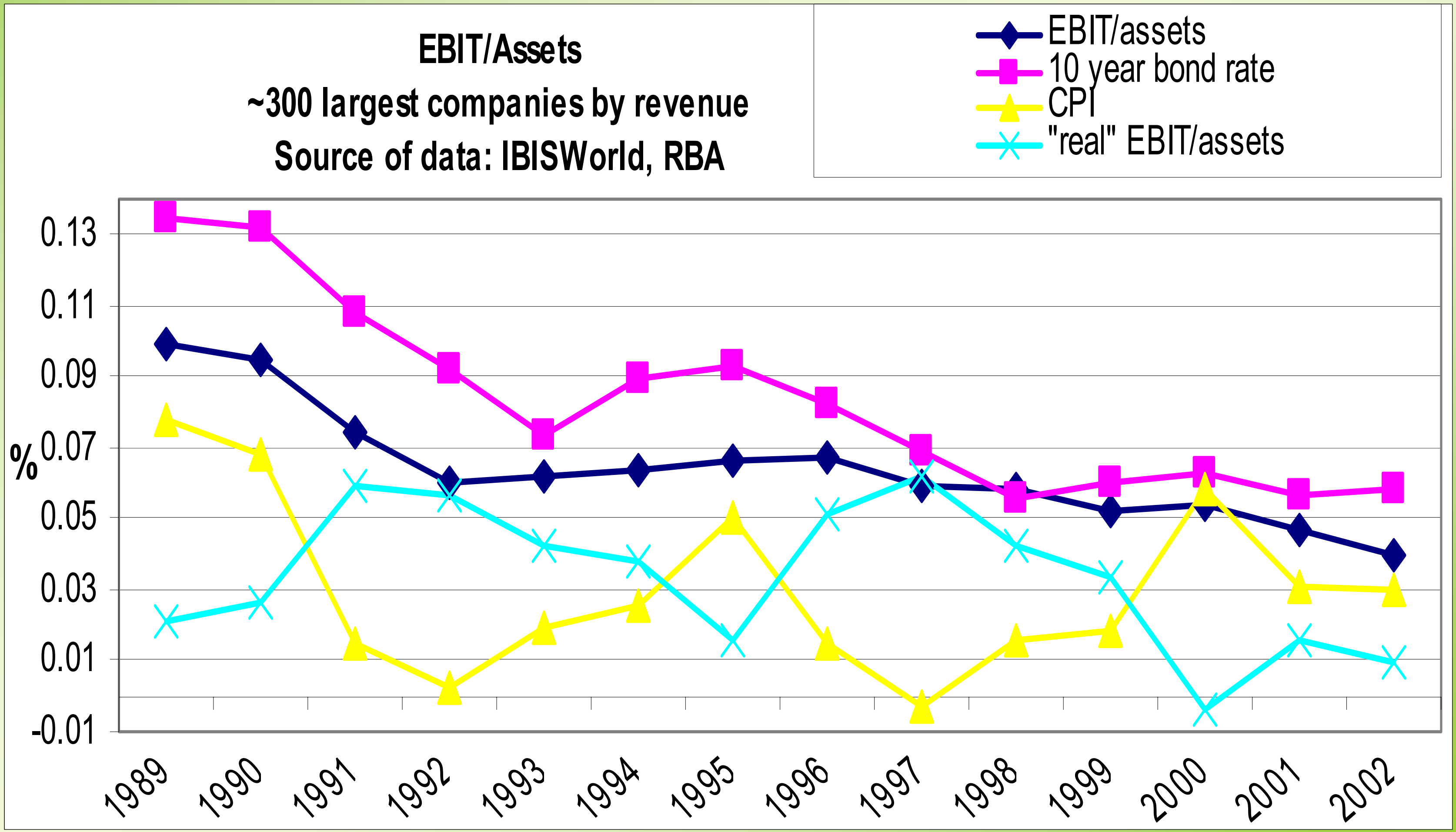
Future capex

- The approach of EA to its past capex does not give any confidence for its documentation for its future capex
- The ACCC is considering an ex-ante approval process for future capex, which gives greater freedom to EA.
- EMRF agrees with this providing EA provides sufficient information to prove the proposed capex is prudent and efficient
- EA must institute systems for proving capex is prudent ***and remains prudent*** throughout the investment duration
- EMRF reluctantly accepts ACCC’s provisional capex allowance ($183.8 million as proposed by EA) but considers it essential for a robust analysis of EA’s resubmission of future capex application

The WACC

- Despite the work by consumers the ACCC persists in awarding WACCs based on MRP and equity beta which are seen as too high
- The EMRF submitted work which is intended to provide a tool to benchmark the WACC awarded
- The ACCC has awarded a WACC which provides EA with an EBIT/RAB averaging >11% for the period (see DD appendix B)
- This is despite EBIT/assets for businesses in the competitive environment of usually less than 10% and averaging ~7% for the past ten years

The WACC


EBIT/Assets
~300 largest companies by revenue
Source of data: IBISWorld, RBA
EBIT/assets
10 year bond rate
CPI
"real" EBIT/assets
%
0.13
0.11
0.09
0.07
0.05
0.03
0.01
-0.01
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002

Past Opex

- GHD had great difficulty in identifying a relationship between the actual opex and the opex awarded for the previous period
- EMRF agrees with the proposed ACCC's 1999-2004 adjustment in superannuation, Olympics, insurance and productivity gains
- However EMRF is very surprised that the past opex is not used as the basis for forecast opex
- It is surprising that an 'efficient' business is not able to implement continuous productivity improvements and efficiency programmes as part of its normal process

Forecast Opex

EMRF

- There is little justification provided which supports the EA forecast
- The ACCC has recognised that the claimed opex is too high, but then accepts it as correct, subject to a fixed deduct.
- The ACCC accepts that a transition from EA's historic approach to opex to the "reliability centred maintenance" approach requires EA to expend increased sums on opex.
- But EA provides no justification or benefit from this change in costing
- The ACCC adjusted historic opex shows a consistent reduction in opex over time, but the awarded opex shows a distinct increase.
- The only capex that might lead to an increase in opex, is an increase in physical assets eg a new line. Even the increase in size of an existing asset should not increase opex
- Despite this increase, the ACCC comments that this *increasing* opex includes for an efficiency factor!

Service standards

- TG achieves >99% line availability, whereas EA achieves an average less than 96%
- EA advises it is different to other TNSPs, implying lesser targets are appropriate
- EA has no data available for other service standards which is surprising for an experienced electricity asset owner
- The ACCC should set targets for EA using standards based on other TNSP performance, but exclude these from the incentive for a period
- The target level for circuit availability set by the ACCC has already been achieved, so the target should be set higher
- As the EA performance levels are low, the EMRF recommends increasing the target levels over time to earn a bonus

Summary

- The EMRF is concerned that there is no penalty on EA for having failed to provide adequate information
- Benchmarking of the WACC shows the value awarded is too high
- The "prudency adjustment" of historic capex is supported
- EA must be required to have in place an auditable method for assessing prudency of capex. This method could follow the principles of quality assurance
- The ACCC approach to opex is not supported as it implicitly accepts the claim by EA, which includes for a major cost increase (for the RCM approach) without providing any benefit.
- An approach similar to that used for TG and Transend should have been used for setting opex, using the actual past five year average as a starting basis
- The approach to service standards is supported in principle, although there should be a higher target and more benchmarks